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PROCEEDINGS

UNIVERSITY OF MISSISSIPPI ESTATE PLANNING CONFERENCE

INDEX FOR VOLUME XXIV

November, 1953

VOLUME XXIV NUMBER 5

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4th Annual Lawyers' And Certified Public Accountants' Tax Institute

Mississippi Southern College
Hattiesburg, Mississippi

November 19 and 20, 1953

Subjects included are:

New Provisions of the Act of 1953
Procedure in Handling Tax Cases
The Section 117 Treasure Chest

Income Tax Consequences of Various Oil and Gas Transactions
A Possible Solution to Employee Problems of the Tax Season

EDITOR'S NOTE

The University of Mississippi Estate Planning Conference was planned for the benefit of attorneys. accountants, trust officers, and life insurance underwriters. The program was designed to present a hypothetical situation which would illustrate the problems of each of the four members of the estate planning team. Special attention was given to the methods of practical planning and to the avoidance of the common tax pitfalls.

The factual situation presented to the Conference will be found in the Appendix, along with the preliminary study and recommendations, the will, and the short term trust. It is suggested that a preliminary study of these materials will result in a better understanding of the text.

Also distributed at the Conference, but not reproduced here, were reprints of the following named articles: Wren, *Congress and the* Church *and* Spiegel *Cases,* 21 Miss. L. J. 223 (1950); Wren, *Taxation of Transfers in Satisfaction of Marital Rights: A Note on* Harris v. Commissioner, 22 Miss. L. J. 212 (1951); Spinney, *The Trust Officer,* 323 Ins. L. J. 749 (1952).

Mississippi Law Journal

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MISSISSIPPI STATE BAR

1953-1954

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PROCEEDINGS OF THE

University of Mississippi

ESTATE PLANNING CONFERENCE

Held at University, Mississippi,
May 1, 2, 1953

ESTATE TAX: WHAT IS INCLUDED IN THE GROSS ESTATE

*Harold G. Wren**

Property which the decedent owned at death is includible in the gross estate under section 811(a) of the Internal Revenue Code. The statute reads: the "value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property outside of the United States—(a) to the extent of the interest therein of the decedent at the time of his death." That raises two points. First, real property outside of the United States is simply not taxed by the federal statutes. There have been a few cases where that point was litigated. For example, hypotecas in Cuba[1] and a ninety-nine year lease in Kenya[2] have been said to be real property, and hence not taxable under the federal estate tax.

The second problem is the determination of what constitutes an "interest of the decedent at the time of his death." A decedent who has a life estate does not have an interest at death because at death the interest terminates. What of a life estate with the power to invade the corpus? It was held that this was not includible under Section 811(a),[3] but was taxable under 811(f), the power of appointment section. Another complex problem is the right to partnership income after the death of the decedent. There are two cases on this point, and they have drawn a rather interesting distinction: In the *Bull* case,[4] the decedent was a partner in a business that apparently did not need a desk, a pencil or any other tangible asset; the decedent could do his business largely in his head. In that situation the United States Supreme Court held that the right to partnership income at death for a period beyond death was not includible in the gross estate. In the *McClennen* case,[5] on the other hand, the typical situation of a partner in a firm with an established office with fixed assets, etc., the right to partnership income for a period after death was held to be taxable. The *McClennen* case will probably be followed in the vast majority of situations.

The next sub-section of 811 is 811(b), referring to marital interests. This is simply a repetition of what has already been said in 811(a) as property in which the decedent has an interest at death. However, according to some of the state decisions in the inheritance tax field,[6] there

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*Associate Professor of Law, University of Mississippi

[1]Fair v. Commissioner, 91 F.2d 218 (3d Cir. 1937).

[2]Estate of de Perigny, 9 T.C. 782 (1947).

[3]Helvering v. Safe Deposit & Trust Co., 316 U. S. 56 (1942).

[4]Bull v. United States, 295 U. S. 247 (1935).

[5]McClennen v. Commissioner, 131 F.2d 165 (1st Cir. 1942).

[6]*See, e.g.*, Matter of Starbuck, 137 App. Div. 866, 122 N. Y. Supp. 584 (1910), *aff'd without opinion*, 201 N. Y. 531, 94 N.E. 1098 (1911).

was some question whether these interests could be treated as property in which the decedent has an interest at death; therefore it was thought necessary to have this stated in a special section. Both the federal law [Section 811(b)] and Mississippi Code Section 9266(b) say that any interests of this sort in the surviving spouse will be included in the gross estate.

The real question in the estate tax is: To what extent are certain inter vivos transfers also includible in the gross estate? That is the problem for the estate planner, and the one upon which we shall focus. If you are planning a man's estate, and the plan calls for some present transfer, you must make sure, to the extent that it is possible, that the property subject to such a transfer will not be includible in his gross estate.

We shall first consider transfers in contemplation of death under section 811(c) (1) (A), or Mississippi Code Section 9266(f). The statute reads: "To the extent of any interest therein of which the decedent has at any time made a transfer except in case of a bona fide sale for an adequate and full consideration in money and money's worth, by trust or otherwise.—(A) in contemplation of death." Now this section has not been given an elaborate, technical meaning as we shall see in the case of transfers intended to take effect in possession or enjoyment at or after death. The leading case, *United States v. Wells,*[7] simply says that in order to have a transfer in contemplation of death, death must be the "impelling cause of the transfer." In giving these words content, the courts have treated this as a subjective problem.

There are three reasons why you need not worry about transfers in contemplation of death. First, if your client lives for three years after the transfer, the Commissioner cannot tax your transfer under section 811(1). Secondly, even if he fails to live for three years, there are a number of things which you can do to prevent the transfer from being considered a transfer in contemplation of death. You should accumulate evidence to show your client's age, his health, motives, etc. Was he trying to save income taxes as distinct from estate taxes? On the cases, that would indicate that he was not contemplating death. For what purpose did he make the transfer? For example, he might want to provide independent income for his independents, to protect his family from business hazards, settle family disputes over marriage, discharge a moral obligation which he owes, or equalize his gifts. Any one of these purposes will take the transfer out of the contemplation of death clause even though your client dies within three years after the transfer. Thirdly, even if it is shown that he died within the three year period and that he contemplated death, it is still cheaper to have both taxes—the gift tax and the estate tax—imposed on your client's transfer than to have just the estate tax. How can two taxes be cheaper than one? The answer is that there is, first, a credit on your estate tax for the gift tax paid on transfers includible in the gross estate.[8] Secondly, the gift tax is imposed in addition to the gift, so that any money used to pay the tax will not be includible in the gross estate.

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[7]39 F.2d 998, *aff'd* 293 U. S. 102 (1931).
[8]INT. REV. CODE, § 813 (a).

The next inter vivos transfer which is includible in the gross estate under section 811 is the transfer with possession or enjoyment retained by the decedent. The Mississippi Code has no corresponding analogue, and such a transfer would be taxable as a transfer intended to take effect in possession or enjoyment at or after death. Section 811(c) (1) (B) provides that a transfer will be taxable if the decedent "has retained for his life or any period not ascertainable without reference to his death or for any period which does not in fact end before his death, (i) the possession or enjoyment of or the right of the income from the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom." This section was put in the Code because of the decision of *May v. Heiner*[9] and subsequent cases[10] which held that the retention of a life estate by the decedent was not a transfer intended to take effect in possession or enjoyment at or after death. That decision went against all prior thinking in the estate tax field, but as I have attempted to show,[11] it was the logical extension of the doctrine developed in earlier Supreme Court decisions. Congress overruled *May v. Heiner* by adding this section. Later, it was also overruled by the Supreme Court in the *Church* case.[12] In the Technical Changes Act of 1949, however, Congress prevented the application of the *Church* decision to transfers made prior to March 4, 1931. This was done by providing that such transfers would not be subject to the estate tax if the decedent died before January 1, 1950, and that decedents who survived that date might release any life estates retained under such transfers tax free, if they did so prior to January 1, 1951.

The next section, which is the most important of all, deals with the transfer intended to take effect in possession or enjoyment at or after death. The Mississippi Code has the same language in section 9266(f); in the Internal Revenue Code, the section is 811(c) (1) (C). Subsection (c) (1) (C) simply states the general rule that a transfer to take effect in possession or enjoyment at or after death is includible in the gross estate. The next problem is what *is* a transfer to take effect in possession or enjoyment at or after death? This phrase goes back to 1826 when it first appeared in the Pennsylvania inheritance tax. The attempt was to reach substitutes for testamentary dispositions. The phrase was at first construed quite broadly, but over the course of the years since the enactment of the federal estate tax, the Supreme Court and Congress, working together, drifted away from a broad interpretation to a highly technical one. The important thing to remember is that in order to have a transfer to take effect in possession or enjoyment at or after death, the limitation of the transfer must be so written that there is a requirement of survival of the decedent. This requirement or survival of the decedent is the sole test of whether a transfer is intended to take effect in possession or enjoyment at or after death, if the transfer was made after October 7, 1949.

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[9]281 U. S. 238 (1930).

[10]Burnet v. Northern Trust Co., 283 U. S. 782 (1931); Morsman v. Commissioner, 283 U. S. 783 (1931); and McCormick v. Burnet, 283 U. S. 784 (1931).

[11]Wren, *Congress and the* Church *and* Spiegel *Cases*, 21 Miss. L. J. 223 (1950). A reprint of this article was distributed at the Conference.

[12]Commissioner v. Estate of Church, 335 U.S. 632 (1949).

There is one other provision in section 811(c) (3) which gives a technical definition of a transfer to take effect in possession of enjoyment at or after death if made *after* that date. Section 811(c) (3) (B) provides that if, under alternative contingencies, possession or enjoyment can be obtained only by surviving the earlier to occur of (i) the decedent's death. or (ii) some other event, and such event did not in fact occur during the decedent's life, then the transfer shall be deemed to be intended to take effect in possession or enjoyment at or after death. The reason for this provision is simply to reverse the holding of the United States Supreme Court, *Reinecke v. Northern Trust Co.*[13]

As for transfers made *prior* to October 8, 1949, there is another rule.[14] First of all, the requirement of survival of the decedent in my opinion, is still there, even though it is not expressly in the applicable section. The important thing is that there are additional requirements. The value of the reversionary interest must be in excess of five per cent of the value of the property subject to the transfer and the reversionary interest must be express and not simply one that arises by operation of law. Only if these additional requirements are met can a transfer be deemed to take effect in possession and enjoyment at or after death. That, of course, got into the Code as a reversal of the *Church* and *Speigel* cases. The result of the *Church* and *Speigel* cases was so shocking that Congress amended the Code, so that as to transfers prior to October 8, 1949, they in effect, over ruled the Supreme Court. At the same time, they provided a special section for refunds for situations within *Church* and *Speigel* and eliminated the statute of limitations with reference to these refunds.

I am now going to leave 811(c) and go to 811(d), which is the section that brings into gross the estate transfers which the settlor makes revocable, or where he reserves certain powers. Again, this is a very simple section if you will remember the fundamental theory: The settlor simply cannot retain any sort of control. If the plan which is developed for your client calls for a trust, you should make it irrevocable. Do not try to keep the property and give it away at the same time. Under certain circumstances, you might deem it desirable to make it fully irrevocable. Wholly apart from tax reasons, the client might want the trustee to handle his affairs and yet retain complete control. If he does that, of course. there is no gift tax but the property is completely includible in the gross estate. Let me mention some of the things that you are apt to encounter. First of all, the *Northern Trust Case* held that the retention of a power of revocation brought the transfer within the scope of a transfer intended to take effect in possession or enjoyment at or after death. At the time of the decision of that case, there was no Section 811(d) as there is today. On the other hand, the same case held that the retention of a power of modification (as distinct from the power of revocation) exercisable by the settlor in conjunction with a person having a substantial adverse interest did not constitute a transfer to take effect in possession or enjoyment at or after death. The latter part of this decision was changed by statute so far as the estate tax was concerned. As it appears today the statute says

[13]278 U.S. 339 (1929).
[14]INT. REV. CODE § 811(c) (2).

that the retention of either a power of revocation (which of course, means to bring back the property to the settlor himself) or a power of modification (which simply means that the settlor retains the right to redistribute the property in any way he sees fit), whether alone or in conjunction with any other person, whether he has substantial interest or not, brings the transfer into the gross estate.

But so far as the gift tax is concerned the rule is slightly different. A transfer where there is a retention of a power of revocation or power of modification, by the settlor in conjunction with a person not having a substantial adverse interest will not be taxable, since it is not a completed gift. The retention of the power of modification, however, in conjunction with a person having a substantial adverse interest makes the transfer a completed gift, and it would, therefore, be subject to the gift tax. It would also be subject to the estate tax, but just as in the case of transfers in contemplation of death, the application of those two taxes normally is not as severe as the application of the estate tax alone.

Continuing on with section 811(d), there are a few other points that you should remember from the point of view of estate planning. Under no circumstances should you set up reciprocal trusts. Before the marital deduction, where both husband and wife had property, it was customary for each to make an irrevocable transfer to trustees for the benefit of the other for life, with remainder over. The husband would give the wife a power of revocation or modification and the wife would give the husband the same. Such cross or reciprocal trusts eventually fell and the reason why they fell is quite obvious. It was simply a way of attempting to get around the restrictions of 811(d). The case on that is *Lehman v. Commissioner.*[15]

Another important point is that the retention of a power of appointment is the same for purposes of 811(d) as the retention of the power of modification. The *Chase National Bank*[16] case decided that. To make a transfer to trustees and retain the power to appoint the property at death is quite obviously the same as a power of modification under 811(d). It is also interesting to note that the power need not be formally reserved. If there is a power to revoke by operation of law, the transfer will come within 811(d). Fortunately, there are not too many of these situations in our law.

Another important point is that the power of revocation and modification and other reserve powers must be exercisable at death in order for the transfer to be includible in the gross estate. The statute, however, places a limitation on this rule. Section 811 (d) (3) specifically says that where the giving of notice is a condition precedent to the exercise of a reserved power, or where the power takes effect only on the expiration of a period after its exercise, it will still be considered exercisable at death.

You should remember *Sanford's Estate*[17] because it laid down the

[15]109 F.2d 99, *cert. denied,* 310 U.S. 637 (1940).

[16]Chase Nat'l. Bank v. Chicago Title & Trust Co., 155 Misc. 61, 279 N.Y.S. 327: *aff'd* 246 App. Div. 201, 284 N.Y.S. 472; *aff'd* N. Y. 602, 3 N.E. 2d 205: *reargument denied* 271 N. Y. 659, 3 N.E. 2d 472 (1936).

[17]308 U.S. 39 (1939).

principle that the gift tax is to be construed in *pari materia* with the estate tax, so far as revocable transfers are concerned. The statement is not exactly true in a number of situations, such as transfers to take effect in possession or enjoyment at or after death, which may come under both taxes. You will have to take the statement in *Sanford's Estate, cum gravo salis.* Nevertheless, it is an important statement and you will see lawyers often saying in their briefs that the two taxes are not both to be applied to the same transfer. I suppose what it comes down to is that the courts apply the phrase when they deem it wise and they do not apply it when they do not deem it wise. It is an important part of our doctrine, however. I might also say that as part of this same doctrine, the income tax is not considered to be in *pari materia* with either of these taxes. It should be treated wholly separately.

Let me review for the moment the five or six types of property which I have discussed as being includible in the gross estate: property owned at death, marital interests, transfers in contemplation of death, transfers with possession or enjoyment retained, transfers intended to take effect in possession or enjoyment at or after death, revocable transfers, and transfers with reserved powers. All of these are includible in the gross estate. That leaves three special types of property for which the Internal Revenue Code and the Mississippi Code have special provisions. They are joint interests, powers of appointment and life insurance.

Joint interests are interesting because they get a peculiar type of taxation. When you study the facts of Mr. Hollingway's Estate, you will notice that he has some joint property included in his estate.[18] How do you determine the proportion which is not includible in his gross estate, because of his wife's contribution? If you take the home, for example, he contributed $7,000 and she contributed $2,000; in other words two-ninths of the fair market value of the house must be eliminated from his gross estate. The burden of proof is on the estate to show the origin of funds used in the purchase of joint property. From 1942 to 1948 community property was taxed in much the same way as joint interests. This was held constitutional in the famous case of *Fernandez v. Weiner.*[19] In 1948 the marital deduction was enacted, and at that time all the law with reference to community property from 1942 to 1948 was repealed.

One of the problems in connection with both community and joint property is that of tracing. In order to show that certain portions are not includible in the gross estate, the taxpayer has to keep very careful records so that he can trace, not only his own separate property and his own community property, but also the separate and community property of his spouse. Even today if you have a client who has some property in Louisiana subject to community property law, you are still going to have to face this tracing problem to the extent that community property is involved.

Powers of appointment are by far the most interesting and the most intricate section from the estate planning point of view, since it makes it possible for the estate planner to get a large amount of flexibility in planning an estate and at the same time prevent the imposition of a heavy tax

[18]See Appendix for an itemized statement of Mr. Hollingway's Estate.
[19]326 U.S. 340 (1945).

burden. In order to understand the Powers of Appointment Act of 1951, it is necessary to review two prior bodies of law: First, the law with reference to powers of appointment as it existed prior to 1942, and secondly the law as it existed from 1942 to 1951.

Prior to 1942, property would be included in the gross estate of the decedent to the extent that such an interest in property passed under the exercise of a general power of appointment. The three important words there are: the property must have *passed;* there must have been a *general* power of appointment and the power must have been *exercised.* If those three requirements were satisfied, then prior to 1942 property subject to such a power of appointment would be includible in the gross estate. A general power of appointment was not defined in the statute prior to 1942 and presumably the determination of whether there was a general power or not would be a question of local real property law. Generally speaking, a power to appoint to anyone not in a particular class would be considered a general power. If the power could be exercised only in favor of certain persons in a particular class it was called a special power, and under no circumstances would the exercise or non-exercise of such a power be taxable. The next question is: What constitutes an *exercise* of a general power? The cases held that where you have a typical residuary clause such as: "all the rest, residue, and remainder of my property, both real and personal, including the property under which I hold such power of appointment, I give, devise, and bequeath to so-and-so," this would clearly constitute an exercise. Under the local property law of some jurisdictions, the power would be exercised by the general residuary clause even without specific mention of the power. The real question and the one upon which the cases turned, however, was the determination of what constituted *passing.* The *Grinnell* case[20] held that if the property went to the same persons under the exercise of the power who would have taken it had there been no exercise, then the property did not pass under the exercise of the power of appointment. This doctrine of "echo limitations" has been limited to situations where the interests passing under the exercise, as well as the persons taking under the appointment, are the same as those which would be created in default of appointment.[21]

In 1942 Congress enacted the Powers of Appointment Act. The scheme of this statute was to define a power of appointment as one in which the decedent can appoint only to his lineal descentants, his spouse, the lineal descendants of his spouse, the spouse of the donor, the lineal descendants of the donor, or the lineal descendants of the donor's spouse. If the power came within that limited category the law said that it did not matter whether it was exercised or not. Property subject to any power broader than that, whether exercised or not, would be includible. As a mitigation device Congress provided that the holder of such a power could release the power tax free within a certain time. Subsequently, every Congress thereafter extended that time right up to the effective date of the Powers of Appointment Act of 1951. At the same time the act was made inapplicable if the decedent died before January 1, 1943, and there was

[20]Helvering v. Grinnell, 294 U.S. 153 (1935).
[21]Estate of Rogers v. Commissioner, 320 U.S. 410 (1943).

no exercise of a power of appointment. Immediately after the 1942 Act, nearly every state, including Mississippi, enacted statutes providing that from the point of view of property law, a power could be partially released so as to cut it down and bring it within the type of power that qualified under the 1942 statute. Still, there was so much dissatisfaction with the 1942 Act that in 1951, the Code was amended so as to give the present Section 811(f) an entirely new structure.

As the law is today, the estate and gift taxes are applicable only to general powers. Further, a general power is defined in the statute. You will remember that, prior to 1942, there was no definition of a general power in the Code. Now, however, it is defined as one in which the power may be exercised in favor of the donee, his estate, his creditors or the creditors of his estate.[22] In other words, if he can somehow get the benefit of the power, he has a general power. In addition, the Code lists several exceptions to the general rule. First, if the donee has a power to invade which is limited by an "ascertainable standard relating to the health, education, support, or maintenance of the decedent";[23] second, if it is a pre-1942 power—that is, one acquired prior to the effective date of the Powers of Appointment Act of 1942—and it is exercisable only in conjunction with another person;[24]—and third, if it is a post-1942 power and it is exercisable only in conjunction with the creator of the power or a person having a substantial adverse interest;[25]—then, in all these cases, it will not be treated as a general power of appointment even though it would otherwise come within the statutory definition.

Two new problems of statutory interpretation have been created in the statement of these exceptions: first, the determination of what constitutes an "ascertainable standard," and second, the return of a "substantial adverse interest" to the estate tax field. The best case on the first point is the *Merchants National Bank* case.[26] That was a situation that involved a life estate to the decedent's wife with remainder over to a charitable beneficiary. Under the trust set up by the will of the decedent the trustee was authorized to invade the corpus, "at such time or times as my said Trustee shall in its sole discretion deem wise and proper for the comfort, support, maintenance, and or happiness of my said wife, and it is my wish that my Trustee shall exercise its discretion with liberality to my said wife, and consider her welfare, comfort and happiness prior to claims of residuary beneficiaries under this trust." As a result of this provision, the taxpayer lost all benefit of the charitable deduction since the power to invade was not measured by an "ascertainable standard", even though it was demonstrated that the life tenant actually expended only a little over fifty per cent of the income from the trust.

As for what constitutes a "substantial adverse interest", you should read the *Prouty* case,[27] which discusses the concept in some detail. In addition, the 1951 statute spells out one very special situation where an

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[22]INT. REV. CODE, § 811 (f) (3).
[23]INT. REV. CODE, § 811 (f) (3) (A).
[24]INT. REV. CODE, § 811 (f) (3) (B).
[25]INT. REV. CODE, § 811 (f) (3) (C).
[26]Merchants National Bank of Boston v. Commissioner, 320 U.S. 256 (1943).
[27]Commissioner v. Prouty, 115 F.2d 331, (1st Cir. 1940).

adverse interest is created: A person who after the death of the decedent is possessed of a power of appointment with respect to the property subject to the decedent's power, which he may exercise in his favor, shall be deemed as having a substantial adverse interest.[28] In other words, where you have a joint power exercisable by *A, B,* and *C* and *A* dies, *A's* interest is deemed to be adverse to *B* and *C,* and *A* is deemed to have a general power of appointment to the extent of one-third of the property. The Code then goes on to say that if the power is a general power of appointment and is exercisable in favor of such other person, such power shall be deemed a general power of appointment in respect of a fractional part of the property subject to such power. This part is determined by dividing the value of such property by the number of such persons, including the decedent, in favor of whom such power is exercisable.[29] The important thing to remember is: If you want to give a client a general power and you want to prevent it from being a general power, all you need do is give it to him so as to be exercisable in conjunction with a person having a substantial adverse interest and you can be sure it will not be a general power.

There are situations where you will want to give the life tenant a general power, particularly to get the benefit of the marital deduction. The wife may be given a life tenancy plus a general power of appointment over the corpus, exercisable under all conditions. Such a transfer will qualify for the marital deduction.

To summarize, first, the Powers of Appointment Act is applicable only to general powers. Second, a general power is defined as I have indicated. Third, pre-1942 general powers will be subject to estate and gift taxes only if exercised. Fourth, as to post-1942 general powers, in the case of the estate tax they are taxable whether or not they are exercised, in the case of the gift tax, they are taxable if the power is exercised or if it is released. A disclaimer or reunuciation of a power is not a release.[30] The lapse of a power by statute is said to be a release.[31] Fifth, as to post-1942 general and special powers—this is the only place where special powers come into the act—if they are exercised so as to create another power and the interest which that power could create would run beyond the period of the rule against perpetuities under the local law, property subject to the power will be included in the gross estate. The moral of this as far as the estate planner is concerned is: Do not exercise the power by creating another power. The exercise of such a power is taxable if used to create another power when under the local law the power can be validly exercised so as to postpone the vesting of any estate or interest in such property or suspend the absolute ownership or power of alienation of such property for a period ascertainable without regards to the day of creation of the first power.

There remains one final problem, with reference to what is includible in the gross estate under the federal estate tax, *viz.,* section 811(g) which taxes the proceeds of life insurance. Mississippi has a corresponding sec-

[28] INT. REV. CODE, § 811 (f) (3) (C) (ii).
[29] INT. REV. CODE, § 811 (f) (3) (C) (iii).
[30] INT. REV. CODE, § 1000 (c) (2).
[31] INT. REV. CODE, § 1000 (c) (5).

tion: Section 9266(e) of the Mississippi Code. On this particular point, Mississippi and federal law are different. Mississippi allows an exemption of $10,000 for life insurance proceeds payable to beneficiaries other than the executor of the decedent.

Let us go back and consider what the law was between 1918 and 1942. Proceeds of life insurance policies which were receivable by the executor or by the estate of the decedent were fully includible. As to proceeds receivable by other beneficiaries, the federal law said they were includible to the extent of the excess over $40,000, under policies taken out by the decedent upon his own life. The regulations during that period alternately said that "taking out" meant where the taxpayer retained incidents of ownership or paid the premiums—one or the other. The situation was finally resolved by T. D. 5032 issued January 10, 1942. This Treasury Decision, which was subsequently put in statutory form by the Revenue Act of 1942, provided that insurance proceeds payable to beneficiaries other than the estate of the decedent would be taxable to the extent that the taxpayer had either (1) paid the premiums directly or indirectly or (2) had retained incidents of ownership. The 1942 Act provided that any premiums paid by the taxpayer prior to January 10, 1941, the date of the Treasury Decision, were not to be considered payments of premiums so long as the taxpayer had not retained any incidents of ownership. At the same time, the $40,000 exemption was eliminated.

It would seem that Mr. Hollingway is very definitely underinsured and that it will be desirable for someone to buy insurance on the life of Mr. Hollingway. If he pays the premiums or has any incidents of ownership, of course, it will be includible in his gross estate. To what extent can the estate plan provide for liquidity by means of insurance proceeds, and still not have those proceeds includible in the gross estate? If Mrs. Hollingway buys a policy on her husband's life, she must be very careful not to mingle her household funds, which she has received from him, with her own independent sources of income, since this may be said to be indirect payment by Mr. Hollingway. What about the Jefferson Dry Goods Store? Could it buy insurance on Mr. Hollingway's life? There you run the risk of the "alter ego" doctrine. The corporation may be said to be the alter ego of Mr. Hollingway in which case the proceeds of the insurance would be taxable to him in his estate.

In line with the *Lehman* case[32] in connection with recripocal trusts, we have the same problem in the insurance field. Do not use cross insurance. Do not have the wife paying the premiums of a policy on the husband's life, even though she uses her own funds, and the husband paying premiums of a policy of her life. If you do, you run into the same problem as in the *Lehman* case and they will be treated as insuring their own lives. Another point: Do not provide in your plan for the transfer of existing policies for a consideration. While it is true that the transfer of policy for a consideration will take the proceeds out of the estate tax, to the extent of the proportionate part for which there was a consideration, at the same time it will subject these same proceeds to the income tax. That can often be far worse than the estate tax.

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[32]See note 15 *supra.*

ESTATE TAX: WHAT IS DEDUCTIBLE

*Harold G. Wren**

The estate tax is imposed on the net estate. The net estate is determined simply by deducting the statutory deductions from the gross estate. There is also the concept of the adjusted gross estate which means the gross estate less the deductions allowed under section 812(b). That concept is used only with reference to the marital deduction. What are the deductions? There are five: first, the specific exemption of $100,000 with respect to the basic state tax[33] and $60,000 with respect to the additional estate tax;[34] second, administrative expenses and claims against the estate so far as such claims are for an adequate and full consideration in money or money's worth[35] (the statute specifically provides that the transfers in satisfaction of marital rights are not for an adequate and full consideration in money or money's worth); third, property previously taxed;[36] fourth, charitable deductions;[37] and fifth, the marital deduction.[38]

The only reason for the difference between the $100,000 and the $60,000 is the way in which the tax developed as a matter of history. The $100,000 is applicable to the basic estate tax. This was the first estate tax, containing a credit for eighty percent of the basic federal tax to the extent that death taxes were paid to the states. Immediately after the enactment of the basic estate tax, Mississippi enacted its present death tax. The rates were calculated so that they were equal to exactly eighty percent of the basic estate tax rates, as they existed at that time. After the enactment of the basic estate tax and after nearly all the states enacted similar death tax statutes in order to take advantage of the credit, the federal government lowered the boom of the additional estate tax. It is that one that has the bite and for all practical purposes in your planning calculations you need only consider that one. Of course, in filing your estate tax return you will go into these detailed calculations but they are all on the form, and all you have to do is follow the form in order to determine the amount of the tax. The Mississippi exemption is $50,000 with an additional $20,000 exemption for life insurance proceeds. Mississippi has no marital deductions, nor do we have splitting of income or gift splitting. As we have said, claims against the estate are deductible under section 812(b). Some of these claims are: first, funeral expenses; second, administrative expenses (I might add that trustees fees, unlike executors fees are not deductible for purposes of the estate tax; but of course, trustees' fees would be deductible on the income tax return of the trust); and third, claims against the decedent.

There are a number of points about this last category. The claims must be existing at death, they must be for an adequate and full consideration

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[33] INT. REV. CODE, § 812 (a).
[34] INT. REV. CODE, § 935 (c).
[35] INT. REV. CODE, § 812 (b).
[36] INT. REV. CODE, § 812 (c).
[37] INT. REV. CODE, § 812 (d).
[38] INT. REV. CODE, § 812 (e).

in money or money's worth, and the relinquishment of marital rights is not considered an adequate and full consideration in money or money's worth. Charitable subscriptions and pledges are deductible under Section 812(b) only to the extent that they are allowed under 812(d), the charitable deductions section. Voidable claims (for example, where the statute of limitations has run) are not deductible. Tort liabilities and liabilities imposed by law are deductible. At this point, you should read Work Sheet No. 5,[39] which is a discussion of the *Harris* case.[40] That case had to do with the gift tax, and held that in a property settlement, if the terms of the property settlement were included in a divorce decree issued by a court, then no part of the settlement could be considered to be a gift. Now the *Maresi* case,[41] which was decided earlier, followed the same theory so far as the estate tax was concerned. There, Judge Learned Hand held that such a transfer was for an adequate and full consideration in money or money's worth and was, therefore, deductible for estate tax purposes to the extent that there was a claim on the part of the wife against the husband's estate. When the *Harris* case came down a lot of the taxpayer's troubles were solved. The only thing that the attorney should remember is that if there is a lump sum settlement in connection with a divorce the settlement should be enrolled in the court's decree. If the taxpayer does so he can get maximum tax value, since there will be no gift tax, and in the event of death, if the wife has a claim, that claim will be deductible for purposes of the estate tax. This type of situation has not been attacked from the income tax point of view where it is a lump sum settlement.

Property previously taxed, the third deduction under Section 812(c), is probably the most complicated section in the entire Internal Revenue Code. It is no longer of any importance whatsoever, and should be eliminated. The best discussion of this entire problem is a recent article by Professor Boris Bittker.[42] Should you get one of these problems, you need to go behind it. Originally, the idea of the deduction was that all property which was taxed to an earlier decedent should not again be taxed to another decedent when the latter dies within five years after the death of the first decedent. That was the statute as it was first enacted, but with every session of Congress all kinds of limitations were written into this section and it became very complicated.

One of the problems was the requirement of tracing. In order to claim the deduction you had to be able to trace the property back through to the first decedent's estate. In handling the first decedent's estate, the executor or his attorney should set up separate bank accounts to keep this tracing going smoothly and to keep track of the property from the estate as much as possible. The second point to remember about property previously taxed, is that the property should be kept from being subjected

[39]Wren, *Transfers in Satisfaction of Marital Rights: A Note on* Harris v. Commissioner, 22 MISS. L. J. 212 (1951). A reprint of this article was distributed at the Conference.

[40]Harris v. Commissioner, 340 U.S. 106 (1950).

[41]Commissioner v. Maresi, 156 F.2d 929 (2nd Cir. 1946).

[42]Bittker, *Previously Taxed Property and the Federal Estate Tax,* 8 TAX L. REV. 263 (1953).

to a general claim of creditors of the estate. If it is made subject to the general claims of creditors of the estate, under our very technical statute of today the amount of the possible deduction will be reduced. So keep those two things in mind. First, keep records that will make it possible to trace the decedent's property for at least five years after his death. Secondly, keep his property from being subjected to the general claims of creditors.

The principal reason why this deduction should be eliminated is that, since the enactment of the Revenue Act of 1948, it is wholly inapplicable as between transfers between spouses. This is true whether the first decedent received the benefit of the marital deduction or not. Suppose that a decedent fails to take full advantage of the marital deduction and his wife dies within five years after his death. Under the present law, to the extent that she received any property from her husband it would all be includible in her gross estate and she would receive no corresponding deduction for property previously taxed. Prior to 1948, it was this very situation that normally involved the application of the deduction since that would be the occasion where you would commonly have the death of a second decedent within five years of the first, where the former would have property received from the latter. Another reason for abolishing this deduction is that one cannot *plan* death. An insurance company, of course, can plan it for a whole group of people but you cannot plan for one of your clients.

The fourth deduction, which is of some importance, is the charitable deduction. There are two things you should know about this deduction. First of all, do not make your charitable gifts out of the residuary estate. The case which reveals this problem is *Harrison v. Northern Trust Company.*[43] Section 812(d) provides that if the tax is payable out of the bequest or legacies otherwise deductible under this section, then the amount deductible shall be the amount of such legacies reduced by the amount of such taxes. This ultimately means that you must determine the amount of this deduction by a very complicated algebraic formula.

Unlike some states, Mississippi does not have any statute providing for the allocation of death taxes. The estate tax is normally a claim against the residuary estate. This need not be the case since the draftsman of the will can always insert a clause stating where the tax burden will fall. This should be specifically stated in the will, but a number of attorneys often fail to do so. As a result, two problems are created: The very person the decedent wants to benefit the most is often the residuary legatee. It is typical in a lot of wills to first make specific legacies to the cook, close friends, aunts and uncles, and then leave the residuary estate "to my beloved spouse." Then Uncle Sam comes in and takes his chunk out of the residuary estate and the position of the person that the testator wanted to take care of is jeopardized. The same problem comes up in connection with a residuary gift to a charity. Without any provision for the payment of taxes, it is impossible to determine what the tax is going to be, since you cannot determine the amount of deduction until you first determine how much tax should be taken out of the residuary estate. But you can-

[43] 317 U.S. 476 (1943).

not determine the amount of the tax until you first determine the amount of the deduction—so you can see the necessity of resorting to algebra. If there is a charitable remainder and the life tenant has the power to invade the corpus, be sure that the extent of such an invasion is measured by an ascertainable standard. This is the problem of the *Merchants National Bank Case,* which we have already discussed.[44]

Finally we come to the grandfather or grandmother—of them all: the marital deduction. The deduction is for any interest in property which passes or has passed from the decedent to his surviving spouse, and which is included in his gross estate.[45] What is an "interest"? The statute has in mind such interests as a life estate, a term of years, future interests and things of that nature. What is "property"? There the statute would seem to be referring to tangible and intangible realty and personalty. For example a life estate in a farm. The term "property" is used in reference to a farm in which the wife acquires a life estate. What is "passes"? "Passes" is defined by section 812 (e) (3) to mean almost any type of transfer which would be includible under section 811. For example, at death, Mr. Hollingway has joint property. Some of that joint property—from the point of view of property law does not pass under his will, but passes by way of the right of survivorship in his wife. That is considered as "passing" for purposes of the marital deduction and to the extent of the value of the joint property going to his wife, that amount will be deductible and will also use up his deduction to that extent.

Section 812(e) (4) is the disclaimer section. If the wife disclaims, the property is deemed not to pass to her for purposes of the marital deduction. If anyone else disclaims, the property is deemed to pass as if no disclaimer was made. What does this mean for purposes of the estate planner? In planning it is better to overestimate the fifty per cent of the adjusted gross estate, which is the maximum marital deduction, since the wife can always disclaim excess and therefore obtain maximum benefit of the marital deduction.[46] Our first basic rule, then, is that the deduction is for any interest in property which passes or has passed from the decedent to his surviving spouse and which is included in the gross estate. A corollary is that the wife can disclaim, in which case the property is deemed not to pass for purposes of the marital deduction. If anyone else disclaims, it is treated as though no disclaimer had been made.

The second point is that the marital deduction is not applicable where there is a terminable interest. In order to make the common law states like the community property states—which was the purpose of the Revenue Act of 1948—it was necessary that the deduction be accorded only to those interests passing to the surviving spouse which are on a qualitative par with the interest obtained by the wife in a community property estate. In order to have a terminable interest, there are the following requirements: first, the interest must be terminable, that is, it must be so limited that it will come to an end (the obvious example is the life estate); second, a per-

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[44]See note 26 *supra.*

[45]For a discussion of what is included in the gross estate, see page 435 *supra.*

[46]In these hypothetical situations, it is assumed that the wife dies first. The reverse would of course be true if the husband predeceased the wife.

son other than the spouse must have an interest in the limitation (again the best example is life estate plus a remainder interest); and third, such person must take on the failure of the spouse's interest. If you have those three things, the interest is terminable and the marital deduction is inapplicable, even though the interest passes to the wife.

There are three exceptions to this rule. First, there is the common disaster clause situation. Section 812(e) (D) says that if the husband puts a provision in his will that the property should go over in the event of the death of his wife within six months after his death that situation will not be deemed a terminable interest although it normally would be. The other two exceptions are: a life estate plus a general power of appointment [section 812(e) (1) (F)], and a life estate plus a general power of appointment under a life insurance endowment or annuity contract [section 812(e) (1) (G)]. What does that mean from the point of view of planning? In the typical situation the wife might be given a life estate and, with reference to roughly fifty per cent the corpus, she may be given a general power of appointment, the other fifty percent to go by remainder interest to the children of the husband and wife. Such a disposition combines flexibility with some tax advantages, and may be a very desirable type of estate planning.

Finally, the third point about the marital deducation is that the amount of the deduction is limited to fifty per cent of the adjusted gross estate. The adjusted gross estate is determined by subtracting the deductions to which the decedent is entitled under section 812(b) from the gross estate. If the estate contains any community property, this also must be deducted in order to determine the adjusted gross estate. Thus, in a community property state where the bulk of the decedent's property would consist of community property the effect of this clause is to make the marital deduction inapplicable.

After the net estate is determined, the tax rates are applied and the tax is determined. There are three credits against the tax. First is the credit for state death taxes. This is limited to eighty per cent of the basic federal tax. As I have indicated, the Mississippi inheritance tax rates have been adjusted in order to take maximum advantage of the credit. The second credit is for gift tax paid. That credit has a limitation arising out of changes in values from the time of the gift until the time of death. In most situations where there have been no large valuation changes, it will be possible to get a full credit for gift tax paid on an inter vivos transfer. The third credit is for death taxes paid to foreign countries.

Probably the most difficult problem is that of valuation. The law permits you, under section 811(j), to take an optional evaluation date, *viz.,* one year from date of death. Normally one year from the date of death will be the cheaper tax-wise because of the tendancy for the value of the assets in the estate to shrink after death.

THE GIFT TAX

*Harold G. Wren**

Unlike the federal law, Mississippi has no gift tax. The gift tax originated in this country in 1924; that statute was repealed in 1926. It did not have the feature of cumulative graduating rates which we have in the present tax. The Revenue Act of 1932 introduced a new concept. Section 1000(a) of the Code provided that for each calendar year a tax shall be imposed "upon the transfer in such calender year by any individual, resident or non-resident, of property by gift." The statute does not define what constitutes a completed gift; this has been left to case law. But section 1002 does say that to the extent that a gift is a transfer for less than an adequate and full consideration in money or money's worth, it is deemed to be a gift. Unlike the estate tax, there is no provision providing that the relinquishment of marital rights shall not constitute an adequate and full consideration in money or money's worth. But in the *Wemyss* case[48] and *Merrill v. Fahs,*[49] the rule that the relinquishment of marital rights did not constiute an adequate and full consideration in money or money's worth was read into the gift tax statute.

Merrill v. Fahs is a rather interesting case which involved an antenuptial transfer between a blonde bombshell in Florida and a tired business man. A very careful contract was drawn—a strictly business proposition. Neverthless, the court decided, as in the companion *Wemyss* case, that this was not a transfer for an adequate and full consideration in money or money's worth and the transfer was therefore taxable as a gift. Now the *Harris* case[50] presented the problem of the post-nuptial transfer. The United States Supreme Court there held that a transfer was not a taxable gift where it was included as part of a divorce decree. From that line of cases, you can get a fairly good idea of what constitutes an adequate and full consideration in money or money's worth.

The gift tax is imposed only on individual donors. A gift by a corporation is treated as a gift by its stockholders. A gift by a partnership is considered to be a gift by the partners. Gifts by non-residence aliens are taxable only if the property is situated in the United States.

In order to have a gift, you must have a donor; the donor must be competent to make a gift; there must also be a donee who is competent to accept the gift and who does accept the gift; there must be an intention to make a gift; there must be delivery of the subject matter of the gift; and the subject of the gift must be an interest in property. Finally, there must be the absence of any power in the donor to revoke the gift or to repossess or exercise any dominion or any control over the property given. Where you have a transfer with power of revocation or modification retained, so that it is exercisable by the transfer alone or in conjunction with

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[48]Commissioner v. Wemyss, 324 U.S. 303 (1945).
[49]324 U.S. 308 (1945).
[50]See note 40 *supra.*

a person not having a substantial adverse interest, such a transfer is not complete for purposes of the gift tax. But where the power is exercisable by the transfer only in conjunction with a person having a substantial adverse interest, the gift is complete. If all these requirements are satisfied, the transferor has made a completed gift and the tax is imposed.

One of the major problems in the gift tax is computing the amount of net gifts. The tax is imposed on net gifts in a particular year, *i.e.,* the total amount of gifts, or gross gifts, less deductions. Deductions for purposes of gift tax are comparatively simple. The charitable deduction follows the estate tax closely and is fully deductable. Secondly, there is the marital deduction for gifts between spouses, fifty per cent of the amount of the gift being deductible. Third, what is called the "specific exemption" of $30,000 for a life time of the donor. He can use this at any time over his life time period. But that does not state the whole case for several reasons. First of all, since 1948 we have had what is known as "gift splitting" which is exactly analogous to income splitting under the joint return of the income tax. Gift splitting simply means that where the husband, for example, makes a transfer of his property to a third person, for purposes of the gift tax, the transfer may be treated fifty per cent his property and fifty per cent his wife's property, so long as the wife consents. This means that over a life time period, you can exhaust the husband's exemption of $30,000 plus the wife's exemption of $30,000 or a total of $60,000 for the family unit.

In addition to the exemptions, we have another proposition which is perhaps the most important concept of all, *viz.,* the concept of exclusions. For any gift, to any person, in any year, you have the so-called "exclusion" of $3,000 each for husband and wife. That means that you do not even have to report the gift if it is under $3,000. And notice that is different from the $30,000 exemption which you have to report and show how you claimed your exemption. But the important thing is this: you have got $3,000 excludible by the wife, or a total of $6,000 a year per donee even though all the property may be the husband's. That is rather important from the estate planner's point of view. If a man has five children he could give away $30,000 a year, without even exhausting any portion of the $60,000 specific exemptions. Or, to put it another way: If James Richard Hollingway wanted to make a gift to his son, Robert, this year and only to Robert, he could give him property of a value of $66,000, and the gift tax would not be imposed at all. Quite obviously, there would be no estate tax so long as he made a complete transfer.

That leaves us with just one little joker: Under several recent decisions the law has been thrown into quite a state of confusion so far as exclusions are concerned. The statute says that the exclusion cannot be taken where there is a gift of a "future interest." The problem is particularly acute in the case of gifts to children under twenty-one. In the *Disston* case[51] the settler transferred property in trust to a trustee to accumulate the income for the benefit of *X,* a child of the settlor, until such child should reach twenty-one. At twenty-one, the trustee was to pay

[51]Disston v. Commissioner, 325 U.S. 442 (1945).

over the income quarterly until the child reaches forty-five; at forty-five to pay over one-half of the corpus, and at death to pay over the balance to the child's then living descendants. The gifts at twenty-one and forty-five are gifts concededly of future interests and no exclusion could be had with reference to those. But the real question is: Are the gifts of the accumulations until twenty-one gifts of future interests, considering the fact that the trustee, under the terms of the trust, was to use the income as necessary for the "education, support, and comfort" of the minors? The Supreme Court held that they were.

As might be expected, the Commissioner has pushed the ruling in the *Disston* case even to the point of arguing that any gift to a minor is a gift with a future interest. There are three cases which have recently discussed this problem.[52] The *Rassas* case came up after the decision on the *Kieckhefer* case in the Seventh Circuit. In the latter case, *Disston* was distinguished on the theory that the gift was one where the minor was entitled to present enjoyment. In *Rassas,* on the other hand, the trustee had discretion to pay over the income of the trust for the maintenance, education, and support of the child within his minority. The transfer was therefore held to be a gift of a future interest. The *Stifel* case was much like the *Rassas* case but it was stronger for the taxpayer and still the case went the other way. The Second Circuit felt that in order for the transfer to be one where the minor would be entitled to present enjoyment, it would have to be shown that he had a disinterested guardian who could demand present payment of the income on behalf of the minor. This line of cases is particularly important for your client when you are planning his estate, if the plan calls for gifts to children under twenty-one. We can only hope that in view of the apparent conflict, particularly between *Stifel* and *Kieckhefer,* the Supreme Court may take up one of these cases and provide us with a more definitive classification of the problem.

THE ROLE OF LIFE INSURANCE IN ESTATE PLANNING

*John Norman Savage**

A good many years ago when the life insurance man first began to sell life insurance, he had to use his imagination and determination a great deal because he was pushed aside as much as possible. Most people did not care to think about life insurance. Now the life insurance man has begun to come into his own in selling the idea of estate planning; he is the one man of the four groups that are represented here that can be aggressive. Insurance is not the only answer, but it plays an important part in any good estate plan. One of the objections in so much of this planning from our clients has been, "Well, this fellow is here just to make a sale; that is the only interest he has." and quite frankly, many times a lot of life insurance men will approach the case up to the point that they

[52]Kieckhefer v. Commissioner, 189 F.2d 118 (7th Cir. 1951); Rassas v. Commissioner, 196 F.2d 611 (7th Cir. 1952); Stifel v. Commissioner, 197 F.2d 107 (2d Cir. 1952).

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can arrive at the tax or the probable tax and then say, "Here is the way to purchase the insurance." There are a good many ways to sell life insurance and then step out of the picture. That is not really complete estate planning; that is just planning according to the amount of tax only and how to meet it.

The primary purposes of life insurance in estate planning is to provide liquidity or cash and there are a good many ways to do this. There are, of course, differences of opinions on some methods. Some of them are perhaps a little bit tricky. If it is not down the middle of the road, a good legitimate clean-cut method, I would not get involved with it. There are so many legitimate ways we can use insurance in an estate plan that we can far exceed the money we make by going along with the entire team and working out a man's problems. It is highly desirable if there are some other members of the family with incomes sufficient to purchase the insurance, if they will ultimately benefit from the estate. But even so, a lot of businessmen and estate owners are not liquid and they do not intend to be liquid because they want to keep their money working and expanding their business, to have the fun of watching it grow. If you cannot find some other method of purchase, then it is quite often reasonable that the man himself will go ahead and purchase the life insurance and put it in his estate even if it increases the total value; he will still come out ahead in the long run.

A short time ago one man said, "Well, I think I will begin to accumulate bonds to meet this tax bill that I know I am going to have some day. I will buy term insurance in the meantime, and some day when the bonds are accumulated I can let the term insurance go." I do not recommend it because the man can purchase permanent plans of insurance for three to five per cent of the ultimate amount that will be paid to someone and accumulate that cash in the policy. It makes good sense if a man needs cash at death to go ahead and pay three to five per cent per year in advance of his death and have the funds available immediately, rather than wait until death to arrange for cash. Even though the estate would stand a substantial loan and the loan could be used to pay the taxes, one still must repay that loan out of high tax dollars with interest. A good many estates are tied up in one piece of property that the man might want to leave intact for the benefit of his family. There is no point in risking the possibility of having to sell it and perhaps destroy the whole estate just to meet the death taxes.

Of course, in the use of business insurance today you will find a close relation between business insurance planning and estate planning. As a matter of fact, often in a good estate plan where most of the estate is the business interest of the estate owner, it is wise to go ahead and use adequate business insurance purchases in your planning—If a close corporation, perhaps a corporate purchase of insurance owned by the corporation for stock retirement purposes.

The life underwriter can be the one man that can be continuously aggressive by the very nature of the way he works, by going out and talking with a man and trying to interest him in the problems of what is going to happen to his estate and his family after death. Sometimes if

an attorney brings this up to a man, he resents it because he thinks it is none of the attorney's business. But a client will let a life insurance man bring it up because he believes that is part of the life insurance man's job. Then if he can interest the client in the next step, he says, "Would you mind if I talk with your attorney, if you have an attorney?" If the man has an attorney, ask for a letter of introduction and the opportunity to talk with him, and then the accountant. Now you can get everybody working together, and then, when you call the client in you can have a plan agreed upon so that you can proceed with the job and there will be no falling apart because of any disagreements among the three or four men of the team.

THE ROLE OF INTER VIVOS TRUSTS IN ESTATE PLANNING

*R. L. Hagaman, Jr.**

The living trust is one of the tools available to the estate planners for the use in helping the property owner to arrange his affairs to do the most for him and his family. When properly handled, it is a business arrangement transacted on a very high plane of conduct. The creator, or grantor as he is also called, must find a trustee in whom the utmost confidence can be reposed. A property owner would not be willing to transfer title to his material possessions to one not so regarded. In addition to integrity in a trustee, there must be found in the one chosen the skill and ability to administer the trust in a satisfactory manner. The test for management is reasonable and such as might be expected of prudent and successful men handling their own affairs, with due regard for production of income and protection of principal. The standard for integrity and fidelity to the trust over and above any personal interest of the trustee is exceptionally high and rightly so. There must be no conflict of interest between the trustee individually and as trustee. The line is rather finely drawn at times, but all doubt must be resolved in favor of the trust, otherwise the trustee should resign.

The trust is an ancient device in our history, involving the separation of the legal and beneficial ownership of property, and in some instances in the distant past the role was not too honorable. In other instances, the purposes served, while not recognized by the common law in England, were finaly sanctioned after the King intervened through his Chancellor to compel performance by the persons promising to act for property owners. These were family situations where provision was made for wives, daughters and younger sons through the *use* device, when land, the chief wealth of the day, could not be left by will but descended to the eldest son on death of the father. These uses were upheld on the basis of the moral and just phases of the cases. The active uses permitted after the Statute of Uses came to be known as trusts and they were similar in nature to the active living trust of today.

Now we have the privilege of leaving all types of property by will as we desire, subject to some restrictions, such as the rights of a surviving

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spouse, but the trust remains as a useful and adaptable means of providing protection and management for heads of families and their dependents. The trust is especially suited for those of the family group who are under age, in bad health, or untrained in business and financial matters. In addition to these purposes, the trust is well designed to effect tax savings under present laws in a perfectly proper and legal manner. While the term "living trusts" includes many kinds, this brief discussion will be confined to those created by individuals, while living, for their own benefit, or for the benefit of some other person or persons. Therefore, the designation inter vivos is appropriate since these are transactions between living persons. An illustration or two will show how this flexible arrangement can be used.

Consider first the revocable trust. This type, of course, can be terminated by the grantor during his lifetime. A typical situation might involve a professional man who had inherited a substantial estate. In order to have more time to devote to his profession, he creates a trust so that the bookkeeping details, custody of securities, reinvestment and management problems can be taken over by his trustee. The income is paid to the grantor as well as principal amounts he might desire at any time. No income taxes during his life or estate taxes at his death will be saved; however, if he directs disposition of the assets remaining in the trust at his death by the terms of the agreement, there will be some savings in administrative expenses since the property would not be a part of his probate estate. The delay usually encountered in the settlement of estates would also be avoided. If the property remained in trust for his wife, to pass on her death to the children, there would be no estate tax against this property on the wife's death, thus saving the second estate tax. In some instances a third estate tax might also be saved.

In the irrevocable trust the grantor does not have the power to revoke the trust. The rule generally is that, if a person creates a trust and does not reserve the right to terminate it, the trust is considered irrevocable. A good example of this type of trust is shown when a person of sufficient wealth to justify the gift, creates a trust to provide benefits for some member or members of his family. The grantor parts with the property completely and with the income from it, thus affecting income and estate tax savings if all the rules are complied with. A gift tax may have to be paid, depending on the amount of property transferred. The tax savings feature is a factor, but it may not be the dominent motive. The grantor may wish to provide for certain members of the family group whose earnings are low and who need the protection of a trust. In addition, any type of living trust gives the grantor a chance to test out his trustee, who might also be named executor and trustee in his will.

The case of Mr. J. Richard Hollinway seems to indicate the use of an irrevocable living trust for some of his property. In this way he could extend financial aid to his children, none of whom are dependent on him, and save some income as well as estate taxes. Assuming no previous taxable gifts had been made by him or his wife, at least $60,000 could be placed in the trust free of gift tax if his wife joined in the gift tax return.

That amount is about as much or more than an active person at fifty-two years of age with an estate of approximately $300,000 would probably be willing to give up.

Do not think because I have spoken of substantial estates and referred to men of wealth that trust services are not available for relatively small amounts. I saw recently an estimate that nearly one-half of the trusts handled by trust institutions in this country had an annual income each of less than $750.00. The principal of many of these trusts amounts to only a few thousand dollars.

Some authors make a classification of ordinary trusts and life insurance trusts, with the latter consisting, partly at least, of life insurance policies as assets. The life insurance trust is created by agreement like the living trust and operates the same way as other trusts. This type of trust is indicated for insurance when it is felt that the services of a trustee are needed to exercise discretion in making payments to beneficiaries to meet unusual expenses which could not be done by the insurance company under the optional modes of settlement. In addition, the trustee might be given the authority to purchase assets from the estate and make loans to it, thereby solving the liquidity problem often encountered. There are many kinds of insurance trusts, such as those used in buy-and-sell agreements for partnership and close corporate interests, both funded and unfunded. Some have tax saving aspects; others do not. Just as ordinary trusts, they are revocable or irrevocable.

From an administrative standpoint, I favor giving the trustee in living trusts, as well as in testamentary trusts, broad powers of investment and management. The trustee needs to be in a position to exercise judgment and discretion in meeting changing conditions as they occur. Anything to hamper freedom of action ordinarily would not be the best interest of the trust. The trust officer is concerned with these administrative provisions since he must deal with the business side of the trust. In setting up the trust he will cooperate with the other advisers of the estate planning team in seeing that the trust does not violate the rule against perpetuities; that the power of appointment, if one is used, is properly employed; that there is no violation of the rules that would destroy the tax saving features; that the insurance arrangements are satisfactory; and that other objectives are clearly worked out.

THE ADVANTAGES OF A CORPORATE FIDUCIARY

*Noel L. Mills**

In all forms of trust services—whether in the administration of an estate, the management of a trust, the handling of an agency account, or otherwise—the advantage of having a corporate fiduciary rather than an individual are so overwhelming that very few, if any, persons who are familiar with them, would be satisfied with an individual serving if they clearly realized the advantages of a corporate fiduciary. Here are some of the advantages that I have made note of for comparison:

*Trust Officer, Deposit Guaranty Bank & Trust Co., Jackson, Mississippi.

Corporate Fiduciary	*Individual*
Has continued existence — Never dies.	May die before or during the administration.
Never ill or away from work.	May become ill or be called away from the city.
Has facilities, such as banking, investments, insurance, collections, real estate, accounting, safe deposits, and others available only in an extensive organization.	Few, if any, of these facilities.
Accumulated experience.	May serve but once in a lifetime.
Financial responsibility. Total assets of the bank as protection.	Only security is his bond, if any, and his personal worth, if any.
If surety bond is required by will or law, a corporate fiduciary is allowed a 33-⅓% discount on the premium. Also, the bonding company does not require joint control over disbursements.	Must give bond equal to full value of personal assets, unless excused by Will. The bonding company requires joint control.
Staff of experts in many lines.	His own personal ability and office help.
Systematic records, modern bookkeeping and accounting facilities.	Usually informal and casual records and accounts.
Group judgment. Sound discretion and judgment which is used by the corporate trustee is based on past experience in handling hundreds or possibly thousands of fiduciary relationships and this discretion and judgment can not be acquired except through past experience.	The judgment of one individual.
Impartiality. All interested parties treated justly and fairly without preference. The corporate fiduciary is able to turn a deaf ear to undue influence which might be exerted by beneficiaries seeking to secure benefits outside the scope of the fiduciary's power.	Personal attachments or feelings may influence decisions.
Supervision of state and government officials.	No supervision except through the final accounting to the court.
Reputation to sustain. Its success depends on the sustained quality of its services. The corporate fiduciary has over a period of years developed a diplomatic manner in dealing with beneficiaries which enables it to safeguard the trust, and at the same time retain the confidence of the beneficiaries. Nothing but experience can attain this end.	Reputation not materially affected by quality of service rendered.

Our trust department in the past has concentrated its efforts on educating the attorneys, life-underwriters and accountants to these advantages for the reason that the majority of our business comes through these sources. As you know, they usually see the prospect first and if they are sold on your services they will recommend your bank to their clients.

Many times we have prospects come to us, and after discussing their estate problems, we feel they do not need our services and suggest that they appoint an individual. For illustration: If a person owns very little except real property in fee simple do not have him appoint a bank as executor, if a trust is not to be created by his will, because the bank would receive nothing for its work and at the same time render very little service. Of course, the real property owner should have a will, so his property would go to those he wishes to receive it, and we encourage him to go to his attorney and have a will drawn, willing his property to the one he wishes to have it.

Most corporate fiduciaries are well schooled in settling estates, and can carry out the provisions of the will fully, promptly and economically, and effect savings in administration of the estate, in some cases more than the fee charged. Also, it must be remembered that the executor's fee is a deductible item in the estate tax return.

AUDIT OF FEDERAL AND MISSISSIPPI ESTATE AND GIFT TAX RETURNS

*Lee R. Spence**

I think I should mention first that the state inheritance tax return is due twelve months after the decedent's death instead of fifteen months as is the federal return. I have been asked to comment on the credit for state inheritance tax. We allow credit to the extent of eighty per cent of the federal basic tax. In the majority of cases the tax paid to the State of Mississippi will exceed the amount of credit. It frequently happens that we can allow no credit at all because there is no federal basic tax, and there are cases where eighty per cent of the basic federal tax exceeds the amount of tax payable to the State of Mississippi. That is where a decedent's property consists largely of property inherited from a prior decedent within two years of the prior decedent's death. In such cases the maximum credit that is allowable is the total amount of tax paid to the State of Mississippi. Property previously taxed is includible in the gross estate where it was inherited within two years of the decedent's death for Mississippi inheritance tax purposes, but the property is allowed as a deduction in a total amount against the gross estate.

We have only two estate examiners in the State of Mississippi and for this reason you can see why we cannot examine a return immediately after it has been filed. However, where it is necessary that the estate obtain a clearance from the Bureau as soon as possible, the executor of

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*Office of the Director of Internal Revenue, Jackson, Mississippi.

the estate at the time of the return is filed should make written request for the examination of the return in accordance with section 825 of the Internal Revenue Code. This section provides that the return must be examined within one year of such request or the executor will be released from any personal libility.

An administrator or an executor, within two months after the decedent's death, must file with the Director of Internal Revenue the preliminary notice Form 704. The notice is an approximate inventory of the decedent's estate, consisting of all of his property at time of death. Form 706 is the estate tax return and must be filed in duplicate under oath within fifteen months after the decedent's death. Before the return is prepared it is a good idea to request examination of any outstanding income tax returns so that any outstanding liabilities may be taken as a deduction in the estate tax return.

The person preparing a return should make it clear, in the space indicated, whether or not the executor elects to value decedent's property as of the date of death or one year subsequent to death. This is very important. Let us say the decedent at the time of his death owned 2,000 shares of U. S. Steel stock worth at that time $150 a share, but one year after death for some reason or other the stock declined in value to $50 a share. You can readily see, with all things being equal, that it would be advantageous for the estate to elect to value the decedent's property as of one year subsequent to death or under the optional valuation date. If such election is made the entire gross estate must be valued as optional valuation date except for the property distributed or otherwise disposed of between date of death and optional valuation date, and then such property must be valued as of such date of distribution or sale. The property comprising the gross estate must be listed on the return not at cost but at the fair market value. Such value is usually much higher than the value placed on the inventory filed with the court.

THE FEDERAL TAX LEGISLATIVE PROGRAM

*Robert Ash**

It is quite obvious that under the new administration there are going to be some substantial changes in the Internal Revenue Code, as well as in the administrative operation of the Bureau of Internal Revenue. Congress is preparing to completely revise and overhaul the Internal Revenue Code. The Joint Congressional Committee on Internal Revenue Taxation has been studying the problem for a long period. It is hoped that by late this year, or the early part of next year, the Joint Committee will be able to present to the Ways and Means Committee a definite program for revising the Code. This program will incorporate many of the suggestions made by the American Institute of Public Accountants, the American Bar Association, the Tax Executives Institute, and other organizations.

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Some of the most important suggested changes come from the Bureau of Internal Revenue itself. Much of the Bureau's research and planning is directed toward simplifying the administrative processes. The primary objective is to find some system by which our vast revenues can be collected, and yet eliminate the necessity for filing and processing many of the millions upon millions of returns which are now annually filed.

An idea advanced by Commissioner Andrews is aimed towards providing relief from filing income tax returns to persons whose tax is withheld by their employers. Employers are now making reports of wages to the Social Security Administration for purposes of establishing wage credits upon which benefit payments may be made. At the same time, the same employers are making reports to the Internal Revenue Service on the same employees for tax purposes. That means that we have more than three million employers making reports on some forty million employees to two separate agencies of the government, with both agencies concerned with the amount of wages paid to the same employees. The Bureau of Internal Revenue recognizes that there must be some way to merge these two reports so as to serve both purposes, and at the same time obviate the need of the employees to file tax returns. The mechanics of achieving these very worthwhile objectives are now being fully explored by the Treasury Department. If accomplished, this change will eliminate the filing of over forty million individual income tax returns. In addition, more than three million employers will be required to file only one return for both social security and tax purposes and thus be relieved of much paper work. The load on the Bureau would be correspondingly decreased if for no other reason than the elimination of the sorting, indexing and numbering of more than forty million individual income tax returns. Of course, the individual taxpayers will be relieved of the headache of preparing and filing returns.

The Bureau feels that one of the greatest steps achieved in tax administration was the adoption of the "optional standard deduction." Most individual taxpayers use this optional standard deduction in lieu of the itemized deductions permitted by the statute. As a consequence, the Bureau's audit costs have been greatly reduced and the tax revenue has not been adversely affected. The Bureau believes that some means should be found to eliminate the need to keep many detailed records by small businesses solely for tax purposes. A study is now being made to find an acceptable formula for a standard deduction to be used on an optional basis in lieu of itemized expenses. It is believed that a formula can be found that will be applicable to small proprietorships, partnerships and, possibly, to small corporations. It now appears that such a plan is feasible and will not decrease revenues.

Another proposal of the Treasury which will affect a great many persons concerns a revision of the system for reporting excise taxes, with a two-fold objective of easing the burden of reporting by the taxpayer and integrating the reports with other types of tax returns so that comprehensive audits of all classes of taxes may be made simultaneously by one visit of examining agents to the premises of the taypayer.

One administrative step has recently been taken which is in accord with the plan to somehow slow up the blizzard of returns which adds to the work of both the Bureau and the taxpayers. Effective July 1, 1953, the filing of all excise tax returns will be converted from a monthly to a quarterly basis. This will reduce the number of excise tax returns filed annually from about seven million to about two million. The saving to the Bureau alone in printing, mailing, processing and related costs is estimated to be in excess of $1,350,000 annually. In addition to this saving by the Government, the quarterly rather than monthly filing of excise tax returns will result in substantial saving to the many thousands of persons who are required by law to collect, report and pay the various excise taxes.

Another Treasury study is interesting because it shows how the present administration is trying to get away from many time-honored traditions. I refer to the use of engraved tax stamps of various and sundry designs. The engraving, inventory controls, and sale of such stamps involves costly operations. The Treasury has already taken two steps to reduce these costs: One has been the substitution of printed forms which take on no value until issued, the other is to substitute metering devices to a limited extent. The Treasury is now trying to develop other types of stamp-metering machines which will dispense stamps somewhat along the lines used by the Postal Service in connection with its parcel post system.

It is quite obvious that if the plans just discussed are adopted, the Bureau will have more money and more men to audit returns of the larger taxpayers.

One of the most important recommendations is that Section 53 (a) (1) of the Code should be amended to provide that the due date for filing tax returns should be changed to the fifteenth day of the fourth month following the close of the taxable year. The Code now provides that all tax returns, except the returns of fiduciaries of estates or trusts, must be filed on the fifteenth day of the third month following the end of the taxable year. Taxpayers and their tax advisers have great difficulty in preparing complete tax returns within that short period of time. Many taxpayers who are in business have audits after the close of the year, which must be completed before their returns can be prepared. In addition, the Bureau itself is unable to cope with the flood of returns it receives during March. The opening of mail and the depositing of taxpayers' checks by the offices of the Directors of Internal Revenue is frequently delayed for some time. The original due date of the fifteenth day of the third month following the end of the taxable year was set many years ago when there was a relatively small number of taxpayers and the computation of the tax was a simple matter. These conditions have drastically changed. Taxpayers, their tax advisers, and the Government would all be aided by the additional time and, of course, there would be no reduction of revenues.

Another very important proposal is that taxpayers should be permitted to elect an extension of time, up to a maximum of two months, for filing a return. Section 53 (a) (2) of the Code authorizes the Com-

missioner to grant a reasonable extension of time for filing returns. Authority for granting extensions has been delegated by the Commissioner to the various Directors of Internal Revenue. Almost all applications for an extension of time are granted. Despite this, an almost unbelievable amount of time is wasted in applying for and granting the extensions. The usual procedure is for the taxpayer or his authorized representative to file an application citing the reasons which would justify the extension requested. The Director thereupon issues a letter granting an extension but, until such a letter is received, the taxpayer does not know whether the extension will be granted and cannot file a tentative return since a copy of the letter must be included in such a return. All this time-consuming procedure takes place during the busy season. There is no reason why the taxpayer should not be permitted to elect an extension of time, up to a maximum of two months, provided some reasonable restrictions were placed on such an election. For instance, a corporation should be required to file a tentative return and pay an instalment of the estimated tax at the time the tentative return was filed. Individuals and other taxpayers should be permitted to elect an extension by filing a simple form having the effect of a tentative return. The extension could be conditioned upon the payment of a proportionate amount of estimated tax liability applicable to any class of taxpayer, such as estates or trusts, that the Commissioner, by regulation, might determine to be necessary.

Another suggestion dealing with administration of the tax laws is that the due date for filing the final delaration of estimated tax and payment of the tax should be changed from January 15 to February 15. The purpose is to permit more taxpayers to file a final return in lieu of amended declarations, thereby enabling the Bureau to process only a return instead of a return and a declaration. Under present law the fifteen days allowed after the close of the taxable year is usually not adequate to collect the information required to file a return.

It has also been proposed that the test for the penalty for substantial underestimation of tax should be based upon the tax liability shown in the return involved, rather than upon the liability as finally determined. In addition, it is proposed that no penalty for underestimation of tax should be made upon a showing of reasonable cause for the underestimate. It is unfair for a taxpayer who makes an estimate in good faith to be penalized for substantial understatement of tax, merely because the tax shown on his return is changed by a Bureau adjustment which he could not predict when the estimate was filed. Furthermore, a penalty for underestimation may result when reported income or a claimed deduction is merely transferred to another taxable year. It is obviously unfair for the penalty to be asserted when the tax liability has to be finally determined by the courts in meritorious litigation, which may be necessary to determine the correct amount of the tax. There have been many inequitable applications of the underestimation penalty. For instance, the Tax Court has recently sustained the penalty where it found as a fact that the taxpayer was of unsound mind when the estimate was made. However, the statute as now written does not contain any provision for eliminating the penalty upon a showing of reasonable cause.

The American Bar Asssociation has recommended certain changes dealing with limitations and penalties which, apparently, are being favorably received. One of these deals with the statute of limitations in case of failure to file a return. There is presently no statute of limitations where no return is filed, however innocently. The proposed amendment would provide a six-year statute of limitations, which is double the normal period where the failure to file a return was not due to fraudulent intent. In the absence of fraud, the reasons underlying the policy of repose in other fields appear equally applicable to tax liabilities. If the rulings of the Commissioner of Internal Revenue at the time the return would otherwise be due are to the effect that no return is necessary and the failure to file results from such rulings, the normal period of limitations should operate just as though a return had been filed and a proviso clause recommended by the American Bar Association so provides.

Another recommendation regarding the statute of limitations deals with the situation where the taxpayer omits from gross income an amount which is more than twenty-five per cent of the amount of gross income stated in the return. In such situations the period of limitations is extended from three to five years. In certain cases, the omission of certain constructive dividends and distributions in liquidation, the statutory period may be extended. The American Bar Association recommends that, where the taxpayer discloses in the return facts sufficient to notify the Commissioner of the omission, there is no justification for extension of the period of limitations.

A very important recommendation is one dealing with limitations in criminal fraud cases. The statute of limitations for crimes arising under the revenue laws is six years. However, §3748 (a) of the Internal Revenue Code suspends the six-year statute of limitations for the time during which the defendant "is absent from the district" where the offense is committed. The offense of filing a false and fraudulent tax return has been held to be committed where the return is filed. The courts have further held that the language suspending the statute while the defendant is absent from the district means when he is absent from the judicial district wherein the return was filed. Yet many taxpayers are required by statute to file a return with directors outside of their judicial district. For instance, residents of the District of Columbia must file their returns in Baltimore, which is in another judicial district. Here in Mississippi a return is filed in Jackson, which is in the Southern Judicial District, Oxford is in the Northern District. In the illustrations I have given, residents of the District of Columbia and residents of the Northern District of Mississippi are not protected by an effective statute of limitations. The same is true of the taxpayer, who for legitimate reasons, may change his residence to another judicial district after the return is filed. The American Bar Association has recommended that the statute of limitations in cases involving crimes under the revenue laws be tolled only for the period the taxpayer is actually beyond the jurisdiction of the courts of the United States.

The first, and probably the strongest, recommendation of the American Institute of Public Accountants was that the Internal Revenue Code

should be made to conform to generally accepted accounting principles. Over the past few years there has been a tendency on the part of the Bureau and the courts to deviate from generally accepted accounting principles and from established principles of law. To put it another way, the Bureau and the courts have attempted to establish a rule for tax purposes which is different from established accounting principles. In its proposals, the Institute points out four specific items which they think should be remedied without delay. They deal with (1) prepaid income, (2) accrual of property and other taxes, (3) apportionment of taxes between vendor and vendee and (4) treatment of estimated expenses and losses which are applicable to the income for the taxable year.

One subject that probably has brought as many complaints to Congress as any other deals with baby-sitters. Working mothers insist that they should be permitted a deduction as a business expense for wages paid to baby-sitters. This is especially true with respect to the low income groups.

Another cause of much complaint is the limitation on medical deductions. First of all, if a taypayer is under 65 years of age no deduction is allowable unless medical expenses exceed 5 per cent of his adjusted gross income. On top of that, there is a maximum allowance of $1,250 multiplied by the number of exemptions allowable under § 25 (b). The maximum deduction is $2,500 except in the case of a joint return by a husband and wife, when it is $5,000. Probably the worst inequity occurs in a situation of a widow over 65 years of age. Such a person's deductions is limited to $1,250. In these days it does not take too severe an illness or accident to result in $1,250 medical expenses.

The requirement for filing declarations of estimated tax seems to have caused a lot of irritation. Study is now being made to see if there is not some way to abolish the requirement of a declaration for most persons. There is some hope that this can be done.

Congress is getting a great many complaints about the so-called double taxation of corporate earnings. Corporations now pay a normal tax of 30 per cent; most corporations pay a surtax of 22 per cent, or a total of 52 per cent. On top of that, many corporations are subjected to an excess profits tax with a rate of 30 per cent. If any of a corporation's earnings left after taxes are distributed as dividends, the recipient must include the amount thereof in income as ordinary income. The British have long recognized the evil of this situation. Under the British system, when dividends are distributed the taxpayer includes in his income the gross dividend; that is, he includes the actual dividend, plus the tax paid by the corporation. He computes his tax on such income and then takes credit against such income equal to the tax paid on the amount of the dividend by the corporation. Several variations of the British system have been proposed. The American Institute recommends the allowance of a credit for dividends received by non-corporate shareholders equal to the initial combined rate of normal tax and surtax on individual income. The Institute points out that their suggested plan would be simple to administer. It would involve no refunds, and all corporate income would be subject to at least the corporation income tax.

A probable result of the elimination of part of the double taxation of corporate earnings will be to eliminate the unhealthy condition which now exists because of the discrimination against equity financing. If a corporation is financed by selling stock, the dividends paid on the stock are not deductible when computing the income of the corporation. On the other hand, substantial tax savings result if a substantial part of the capital is borrowed and represented by bonds because the interest on the bonds is deductible in computing the corporation's income. The tax result is the same insofar as the investor is concerned. The alleged unfairness from a tax viewpoint is not the only evil of the situation. It is generally recognized that equity financing is preferable to bond financing. In times of adversity the fixed interest charges may produce insolvency, or the whole economy may be damaged by steps that will be necessary to avoid insolvency, and for this reason the Securities and Exchange Commission and state utility commissions repeatedly have urged the reduction of bonded debt. The tax system operates to encourage bonded debt.

Something is going to be done about the allowance for depreciation. Congress has received many complaints because of repeated adjustments in depreciation rates, but at this time it is difficult to tell how far it will go in liberalizing the depreciation allowance. Canada has had very satisfying results by permitting taxpayers to elect almost any period they desire within which to write off capital assets. One plan proposed is to allow accelerated depreciation on all new plants, machinery and equipment. Owners of new plants would be permitted to depreciate one-half of the cost over the first quarter of the useful life. Thus, if you build a new plant at a cost of $100,000 and it has an estimated life of twenty years, you will be permitted to depreciate it at the rate of $10,000 a year for the first five years. Ordinarily, people do not invest in new plants unless they see an immediate need for the new facilities. On the other hand, the long term picture might not justify the expenditure. This proposed provision in many instances would result in construction of new facilities. In such a situation, a snowball effect on business and earnings would result. Dozens of enterprises would benefit by the new construction and, consequently, pay increased taxes. In other words, the income of the engineers, architects, the building contractors, the machinery manufacturing companies, the transportation companies, the workmen employed and the like, would all be increased so that the revenue would correspondingly increase. The Government could not suffer because, in any event, the taxpayers who acquire the new facilities can only recover their cost through depreciation. It is interesting to note that the late President Roosevelt was very much interested in the suggestion just mentioned. In a speech which he made October 29, 1944, he stated:

> ". . . Business large and small must be encouraged by the Government to expand their plants and to replace their obsolete or worn-out equipment with new equipment, and to that end, the rate of depreciation on these new plants and facilities for tax purposes should be accelerated. That means more jobs for the worker, increased profits for the businessman and lower cost to the consumer."

Both the American Institute and the American Bar Association think something should be done about the deductibility of business bad debts. Under existing law, distinction is made between business bad debts and non-business bad debts. The distinction is important because the former are deductible in full and the latter (in the case of taxpayer other than a corporation) are treated as short term capital losses which are deductible only against capital gains, plus not more than $1,000 of ordinary income. The nonbusiness bad debts is so defined under existing laws as to include true business bad debts which do not become worthless until after the taxpayer has terminated his business. It is recommended that the section be amended as so to permit the deduction as a business bad debt of any debt arising in the course of the taxpayer's trade or business.

Something probably will be done with respect to alimony paid under a separation agreement. Under present law, amounts paid in accordance with the terms of a separation agreement between husband and wife, where they are not legally divorced or separated under court decree, are not deductible by the husband nor taxable to the wife. The probabilities are that the law will be changed so that amounts paid under the written separation agreement will be deductible by the husband and taxable to the wife, even though they are not legally separated under court decree.

There is still a lot of complaint about the capital gains and losses provision. In England, capital gains and losses usually are not recognized for income tax purposes because they are considered as "casual" and thus contrary to the definition of receipts likely to occur periodically. In this country there is a variance of opinion as to the proper treatment of capital gains and losses. On one side, Godfrey Nelson, the distinguished tax expert of the *New York Times,* says:

> "This column ventures the opinion that no other single revision of our tax system would do so much to create incentive and investment ability as the elimination of the tax on capital gains."

The theory behind this viewpoint is that the elimination of the capital gains tax would permit withdrawing capital from old established enterprises and re-using it to create new enterprises. On the other hand, the substantially lower rate of tax on capital gain than on ordinary income provides a temptation to create various sorts of artificial devices to try to convert income into capital gains. The principal complaint to Congress seems to be the limitation on the deduction of capital losses. There seems to be much justification for the position that if a person has incurred an economic loss through some capital transaction, he should be permitted a larger deduction than that permitted under present law.

Some legislation has been urged to straighten out the confusion which now exists with respect to the deduction of industrial and commercial research and development costs. It is difficult to apply orthodox accounting principles to such expenditures, and there is no uniform accounting practice with respect to such items. Treasury Regulations formerly permitted taxpayers to elect either to deduct as expense or capitalize such charges, but such Regulations were, in effect, held invalid by decisions of the Board of Tax Appeals. Present regulations indicate that such expendi-

tures must generally be capitalized and recovered by a depreciation allowance if the taxpayer can show that the intangible business asset has a useful life in the production of business income for a reasonably definite limited period. In practice it is frequently difficult, if not impossible, to determine the useful life in the business of an industrial or commercial product, service or process, resulting from research and development expenses. It is proposed that at the election of the taxpayer these expenses may be deducted as expenses, or capitalized and charged off over a period selected and designated by the taxpayer.

The American Bar Association and the American Institute recommended that § 112 (d) (7) becomes a permanent part of the Internal Revenue Code. This section gives an election as to the recognition of gain in certain corporate liquidations. Many corporations having no substantial accumulations of earnings and profits nevertheless hold real estate, unlisted corporate securities, or other assets which are not readily marketable, but which have considerably appreciated in value. The section in question permitted the liquidation during 1952 of such corporations and taxed the individual stockholder as ordinary income only on that part of the distribution which represents accumulated earnings. The unrealized depreciation in value of assets was not taxed to the stockholder upon liquidation of the corporation, but was postponed until the stockholder sold such assets. The section in the present Code was limited in application to the calendar year 1952, but there is no reason why this should not be applicable to all years.

Another troublesome problem which should be corrected deals with situations such as existed in *Commissioner v. Court Holding Company*[1] and *United States v. Cumberland Public Service Company*.[2] Under existing law, if a corporation is liquidated by distributing its assets to its stockholders, no tax is imposed on the corporation on any appreciation in the value of assets over the adjusted basis or cost to the corporation. As far as the stockholders are concerned, any excess of the value of such assets over the cost or other basis of the stock, is taxed as capital gain. On the other hand, if the corporation sells its assets just prior to liquidation a tax is imposed on the corporation, and when the proceeds are distributed to the stockholders another tax may be collected from the stockholders. A great many disputes have arisen between the Government and the taxpayer as to whether a sale was made by a Corporation or by its shareholders. It is recommended that if a corporation sells its assets just prior to liquidation, no gain or loss shall be recognized to the corporation.

Something may be done with respect to Section 102, which imposes the tax on the accumulation of earnings by a corporation which is clearly beyond the reasonable needs of the business and is motivated by a purpose to save taxes to the shareholders. If the double taxation of corporate earnings is eliminated, or substantially reduced, this problem will largely vanish. It has been strongly urged that the burden of proof be on the Commissioner in Section 102 cases.

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[1] 324 U.S. 331 (1945).
[2] 338 U.S. 451 (1950).

Both the American Bar Association and the American Institute recommend some changes in the taxation of annuities. Under present law annuity payments are treated, in part, as a nontaxable return of premiums. and the balance as taxable income. However, the formula used treats amounts received each year to the extent of three per cent of the consideration paid for the annuity as taxable income, and applies the remainder against basis. The American Institute points out that most annuity contracts now in existence are based upon a lower interest yield than three per cent. The American Bar Association points out that, after the basis is recovered, all further payments are income in full. This places a greater tax burden on an annuitant, who outlives his expectancy, at a time when he is really old and probably needs the full annuity more than ever before. Both the American Bar Association and the American Institute recommend a constant yearly exclusion for the life of the annuitant. If he lives out his life expectancy, he will recover tax-free exactly the cost of the annuity. If he lives beyond such expectancy, he will recover tax-free more than his premiums paid. If he dies before the expiration of such expectancy, he will recover less. However, on the average, the results are equitable and the revenue will not be reduced; in addition, the annuitant's taxable income from this source will be constant.

The American Bar Association feels quite strongly that the computation of the estate tax should be simplified. It has proposed that credits be combined so that the tax can be computed by applying a single schedule to the net estate. The net estate would be arrived at by subtracting a single specific exemption and then subtracting a single set of credits.

The American Bar Association has also proposed that something be done about the optional valuation. Under present law an executor can elect at the time he files the estate tax return to value the property of the decedent as of date of death, or as of a date one year after death. This election, once made, cannot be changed. It sometimes happens that at the time the return is filed, the executor considers the election to be of no importance because the value of the gross estate is less than the specific exemption authorized by law. If the Commissioner later increases the value of the gross estate by adding gifts which he said were made in contemplation of death and which the executor had considered not a part of the gross estate, the election may become very important. It is proposed to make the election available to the executor of an estate not only at the time the return is filed, but also at the time the election becomes important because of the inclusion by the Commissioner of other assets in the gross estate, or because of the increased valuation of reported assets.

The American Bar Association has also proposed insertion in the Code of a provision for extending the period of limitations in the case of estate and gift taxes. Under existing law the Commissioner has no authority to enter into an agreement with the taxpayer to extend the time within which the estate tax, or the gift tax, may be assessed. Such authority does exist in the case of income taxes. Occasions arise in which the absence of this authority means that the settlement negotiations must be hurried or that no real negotiations can be undertaken at all because of the shortness of time within which the Commissioner may assess the tax.

A proposal dealing with Tax Court procedure will probably be enacted. Under the law taxpayers who receive a notice of deficiency may appeal to the Tax Court, and the Tax Court has jurisdiction if the appeal is received within 90 days from the date the notice of deficiency was mailed. Some cases of extreme hardship have resulted where taxpayers have mailed their petitions in ample time to be received within the 90-day period, but for some reason they were not received within that period. Under a proposed amendment the Tax Court will have jurisdiction if the petition is mailed by registered mail within 90 days after the date of the mailing of the notice of deficiency.

During the past two or three years there has been a great increase in the number of tax fraud cases in which criminal proceedings have been instituted. Until a few years ago the Treasury had a policy known as the "voluntary disclosure" policy. If a taxpayer who had filed a fraudulent return repented, he could escape criminal prosecution by filing an amended return, or by advising some responsible Treasury official that he had filed a fraudulent return and now wanted to make good his wrong. The Bureau has discontinued this policy. There is considerable doubt as to the wisdom of the Bureau's action, and it may very well be that we will again have a voluntary disclosure policy created either by administrative action or by legislation. The whole problem is now under active consideration.

PRESENTATION OF THE PLAN — PART I

*William J. Bowe**

Once the data is assembled,[1] there are three beginning points. We should determine Mr. Hollingway's gross estate. What is it worth? Of what does it consist? Then we know what we have to deal with. We should next consider the amount of his liquid assets. At this point we ought to make some tax computations to determine what his tax will be and to what extent, if any, he ought to consider using the marital deduction. Once we get over these three hurdles, we have a clearer picture of what he ought to do.

Valuation Problems

There are some assets that do not cause us any trouble. We have cash on deposit; we have his interest in the Jefferson Gin Mill; we have some marketable securities; we have some bonds and notes—items that are readily valued. Nevertheless, one problem that can give us trouble is determining the value of his gross estate. The residence we included at seven-ninths of its value, because he and his wife had purchased it originally for $4,000. He then added $5,000 so that he contributed seventh-ninths of the cost. Remember, with respect to jointly owned property you include

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[1]Reference should be made here to work sheets 1 and 2 in the Appendix.

in the estate only the portion for which he paid. In arriving at the gross estate the full value of the jointly owned property is included, less that portion which the survivor can show she contributed.

In our case, Mrs. Hollingway only contributed $2,000, so we have the residence in at $14,000. We, of course, have added in the $8,000 cash. The life insurance goes in even though it is payable to a named beneficiary. I think that is not true under Mississippi law,[2] but under federal law the proceeds of life insurance are included if the decedent-insured owned the policy or paid the premiums, and in this case he did both. The farm property we have here at $90,000. We have to examine the client carefully on items like this. Ultimately, we are going to have to get some appraisals when the estate tax return is filed, and, if it is important enough even in the planning stage it might be worth while having an appraisal.

Valuation is always a difficult problem, but I do not think that is something we ought to worry about too much. I always like to have some difficult valuation problems in negotiating the settlement of a decedent's estate because they help you in other respects. We have the valuation issues that are present in every estate, and the chances are that because of the additional issues we will make a much better deal with the Commissioner. We can say, "All right, we will concede that the gift was in contemplation of death if you will be reasonable about the valuation of Blackacre, or we will let you increase its value substantially if you concede to us the debatable contemplation of death or the indirect payment issue." You must realize that in taxation we are dealing mostly with pure questions of fact, the questions upon which reasonable minds may differ. In large measure we come down to an ultimate compromise, and the more issues we have the better compromise we are going to make.

There are a few items—the residence and the household furnishings—on which we can safely take his guess because they are not large. But do not overvalue household furnishings. What we are interested in is market value, not use value. Its use value or replacement value may be $1,000 and he ought to insure it against loss for $1,000, but in estate taxation we are interested in what it can be sold for. The same principle applies to jewelry.

The difficult valuation problems in Hollingway's case are the bank stock and dry goods stock. The most frequent method used in the valuation of closely held companies is the capitalization of earnings, and I think generally the taxpayer will come out best on a valuation study based upon capitalizing the earnings in relationship to marketable securities. The statute now provides that that is one of the factors which the Commissioner must take into consideration.

What we have to do is try to approach this valuation question by three or four different methods—capitalization of earnings, appraisals, any offers we have, sales of similar businesses, etc. Gradually, by approaching it in three or four different ways, we reach a mean or average

[2]Mississippi law provides for an exemption of $20,000 for insurance proceeds payable to beneficiaries other than the decedent's executor or estate.

figure. The big item is the capitalization of earnings. If you will study, or get a broker or investment man to study, your stock exchange companies that are substantially similar, he will find the differences that ought to be deleted in your favor; then discount for non-marketability, and you begin to approach a figure that you can sustain. Obviously, here there ought to be a big amount off on account of non-marketability because Hollingway's stock cannot be sold in twenty-four hours.

Liquidity

As to liquidity, we have $50,000 including the insurance—$8,000 cash, $15,000 insurance, stocks at $18,000, and bonds at $9,000. We look pretty good from a standpoint of liquidity. Usually this can be a very troublesome problem. Where it is present, there are two ways of solving the liquidity problem: (1) Through the purchase of insurance, preferably by someone other than the insured, to provide the needed funds; (2) Through the making of lifetime gifts in order to reduce the need for liquidity.

We do not have this problem present here in a really pressing way. To decide this, I made some tax computations with and without the marital deduction. I took his estate at $309,000. I deducted $19,000 for administration expense, just to get a nice round figure. Administration expenses are going to vary. In very large estates the figure may be as low as 4 per cent or 5 per cent; in small estates it may be as high as 10 per cent or 12 per cent. On this basis, after taking the $60,000 exemption, we have a net taxable estate of $230,000, and a $57,000 federal tax. But if we use the maximum marital deduction, we have a net taxable estate of only $85,000, and only $16,000 federal tax. His maximum death costs (federal and Mississippi death taxes and administration expenses) may total $81,000, unless we were very wide of the mark on our evaluations. If he uses the marital deduction—gives his wife one-half of his adjusted gross estate—his federal taxes will be only $16,000, instead of $57,000, a difference, through the use of the maximum marital deduction, of $40,000. Should he use it? That presents a very difficult question.

His wife's father is 81, and he just will not tell what his estate plans are. We do not know what he is going to do; we do not know how much he has. Hollingway has estimated his father-in-law's wealth as somewhere between $200,000 and $500,000. If he leaves half to Hollingway's wife and half to her brother, but leaves her share in trust, we will want to use the marital deduction in full. If he leaves it to her out-right, we will not want to use it at all, because it would prove very costly. When you do not know, it seems to me always desirable to use the deduction in full. First, we can put in the will a provision that the wife may renounce the gift, in whole or in part. I think it wise to include a specific provision that she may renounce it in whole or in part as there is some doubt under state law whether you may partially renounce. By the time Hollingway dies, it is extremely likely that all the facts will be known—what the father has, and what he has done with it. If it then appears undesirable to use the deduction, his wife may renounce. Second, if she accepts this bequest we

find that his estate will save $40,000. But should she inherit $150,000 out-right from her father, her tax, through the use of that marital deduction in her husband's estate, will be increased by $45,000, and it looks as though it costs $5,000 more to use it than not to use it under that particular contingency. But Mrs. Hollingway will have had use of that $45,000 for a substantial time if we save it in his estate, since it does not have to be paid until she dies, which may be five, ten, or fifteen years later. Meanwhile, she will enjoy the income from it. Lastly, following his death she will be older, the children will be older, and there will be a much greater incentive than there is now to make gifts. She will then be in a position to begin making gifts to the children at gift tax rates which are substantially less than the estate tax rates.

Gift tax rates were fixed at exactly three-fourths of the estate tax rates, but the saving from a gift is always tremendously larger than that because you have a gift tax exemption and a gift tax exclusion. Then the money that is given is taxed at the lowest gift tax rates but removed from the highest estate bracket. To give you an illustration: A man with $200,000 gives away $50,000. He takes off $30,000, he takes off $3,000, and he pays on $17,000 at rates beginning at 2¼ per cent—total tax is $954 on a $50,000 gift. He has removed the whole $50,000 from the 30 per cent estate tax bracket, so that he saved $14,000 in estate taxes.

Methods of Using Marital Deduction

If we use the marital deduction, there are two methods. We can either make the gift to the widow of a fixed dollar amount, or we can use a percentage. Mr. Trachtman is going to tell you about the evils of percentages, but I want to tell you about the evils of the fixed amount. You have to make a wild guess. A figure of $150,000 here looks as though it comes pretty close, but the only thing we know is that Hollingway's assets are going to be different when he dies than they are now. If you go wide of the mark, either over or under, it is going to be costly from a tax viewpoint. For this reason, I tend to favor a percentage method where you have family harmony, as we do here, and where we do not have too many lifetime transactions.

Lifetime Gifts

What should we do about gifts? It is useless for Hollingway to give his wife any money. No income tax saving will result, because they file a joint return. She is well taken care of now. Her father is likely to leave her a substantial sum. If there are any gifts, they ought to be to the children. In cases where gifts are made to wives (and there are many situations where it is advisable) do not make the mistake that *X* made. He gave his wife $300,000 back in 1935, and he paid a gift tax of $60,000. Five years later his wife died. Under an old will, drawn fifteen years earlier, she left "all my estate to my beloved husband." So all that $300,000 came back to him, less the $54,000 estate tax. He was back where he started, except for the $116,000 that went to the Government. Gifts of substantial sums should be made to trusts to avoid estate taxes on the deaths of the donees.

It seems to me that it is going to be very difficult to persuade a man 52 years of age—Mr. Hollingway's age—to make substantial gifts to the children. He has, or at least thinks he has, another twenty-five years of living ahead of him, and he does not want to lose control of his wealth. If he makes any gifts at all, I recommend that he create a small life insurance trust for the benefit of his children. He does not have the ideal kind of assets to put in such a trust, but looking over his assets, the best one to take would be the $50,000 preferred stock of the dry goods company. If he gives that to a trustee, authorizing the trustee to buy life insurance policies on each of the three children, using the income each year to pay the premiums, he will first of all get $50,000 out of his estate with very substantial estate tax savings. He will pay no gift tax because he has a $30,000 exemption and his wife the same. This would be a gift of a future interest so we could not use the annual exclusions, but it would be well within the two exemptions. The income will be taxed to the trustee because it is income that is accumulated. It will be taxed to the trustee at 22 per cent instead of Mr. Hollingway's top bracket of 56 per cent or 59 per cent, so you would save almost $1,000 annually in income taxes. The children would be relieved of the burden of carrying insurance. If a trustee does not do it for them, they would feel morally obligated to do it and would have to do it out of income which had already been subjected to high bracket income taxes. When the children die, no part of the insurance will be included in their estates, because they neither owned the policies nor did they pay the premiums. When the trustee receives the proceeds, you may terminate your trusts or you can continue them until the grandchildren reach twenty-one. Meanwhile, the proceeds may be made available on the deaths of the insureds through an authorization—but not a direction—that the trustee may purchase non-liquid assets from the estates of the insureds.

Jointly Owned Property

We have a little problem here on the jointly owned property. Joint ownership is not the most desirable way of holding property. There is no estate tax saving from joint ownership; the full value of the asset is going to be included in the estate of the decedent who paid for it. It can result in very disastrous income tax consequences.

A man buys Blackacre for $5,000 in 1934, the depths of the depression, taking title in the joint names of himself and his wife. He died in 1945 without any estate except the real property, which passed immediately to the wife because of the joint ownership. She sold it within a few months for $20,000. She had to pay income tax on the difference between the $5,000 and the $20,000—$15,000 long term capital gain. Had he taken the title in his own name and given a lawyer $25 to draw a will for him, leaving the property to his wife, she would not have paid any income tax at all, because the asset would have taken a new cost basis at his death.

One solution for Hollingway would be for him to convey the residence to his wife. That would get it out of his estate, but he would retain the low cost basis. Another would be for the wife to convey her interest back to him. That would not save estate taxes. The situation would remain as

it is, but there would be a chance of a new and higher cost basis. A third alternative would be to create a tenancy in common. Here you compromise. You get half the estate tax benefit and half the new cost basis. Lastly, you can leave it as it is. There is no easy answer. You have to look at each case individually. Here I would probably leave it as it; it does not amount to much. This lady is going to have enough wealth to stay in that residence for the rest of her life so that the cost basis problem is not likely to arise. There are some advantages in leaving it as it is. You save some administrative expenses and delays, and you free the property from the claims of creditors.

Sale of Business Interests

The dry goods company present us with a problem. Hollingway's father had employed Drake as manager, and young Drake is working there now. Hollingway's father never did recognize all Drake had done in building up the business. Hollingway himself has taken all the benefits of Drake's work. Drake wants an opportunity to buy, and Hollingway wants to give him that opportunity. Further, none of Hollingway's family is really interested in this business. We have here an ideal situation for a purchase agreement by the two Drakes on the death of Hollingway. The better plan is to have the agreement to buy on the death of Hollingway because if he sells now he is going to have a big capital gains tax, and he probably can keep the Drakes happy with a present contract to sell at death. His children will be much better off if they can get $60,000 out of the common stock and invest it in marketable securities, particularly as they have no real interest in the business.

How are the Drakes going to pay for the common stock? They have never been paid decent wages so they have not accumulated money. If they could buy $60,000 of insurance on the life of Mr. Hollingway, there would be a fund available. Perhaps he could increase their salaries, but he must not do this so obviously that it will look like a method of indirectly paying the premiums. I think you would have a pretty good presumption that he was not indirectly paying them because the Drakes are strangers to him.

How are we going to fix the price? The common stock of the department store may be worth only $30,000 when he dies; maybe it will be worth $100,000. Here are three methods: One, we can have a fixed amount to be adjusted year by year. The big objection to this method is that the people just do not sit down and agree again. Ten years will have elapsed and they will not even have discussed changing the original figure; people just forget or postpone it. Even if they did not, when the time comes that Hollingway looks as though he might die this year, agreement is most improbable. If the price is high the Drakes are not going to agree, and if the price is low he is not going to agree to a new figure. The second solution is to use a times-earnings formula, *i.e.* seven times the average earnings of the last five years. Here we allow for a very considerable amount of fluctuation. Either of these two ways will freeze the value for estate tax purposes. The third method is to have the executor and the buyers agree. If they cannot agree each is to appoint an appraiser, and

if the two appraisers cannot agree they are to appoint a third whose determination is to be final. You can use any one of the three.

If you use the times-earnings formula, or a fixed price—to be adjusted from time to time—you can freeze the value for estate tax purposes. Thus, if they agree upon $60,000 and the contract is properly drawn, it will freeze the value so that the Commissioner must take the $60,000; he cannot argue for a higher figure. In order to achieve this result, there are three requirements: First, the agreement must be an arm's length transaction. We would normally have that in this situation, where we have people outside the family. Second, the estate must be obligated to sell, and the restriction must bind the stock during Hollingway's life so that he can not sell it free of that obligation. If Hollingway had agreed to sell at $200 a share "whatever shares I happen to own at my death" he would have a binding contract, enforceable against his executor, but the Commissioner is going to disregard it, because he was free anytime during his life to sell at any figure he liked. Third, the agreement must not merely give the Drakes the first refusal. Thus, "we will offer it to you for $200 before we offer it to anybody else at any figure" will not do. Here we have something that may depress the value, but it does not fix it because the estate may decide to keep the stock, and there is a lot of value in keeping as well as selling. If it is worth more than $200, they will keep it. If you want to freeze the value for estate tax purposes, the agreement must bind the stock during the owner's life so he cannot sell free from the restriction, and the estate must be obligated to sell at his death. The buyer may have an option to take or not, but the estate must be bound to sell.

With respect to the bank stock, we might use a somewhat similar arrangement with young Beck. Beck has twenty-five shares and the father has one hundred. The children have no interest in the bank, and Hollingway would like Beck to carry on. Beck might buy one hundred shares at $30, or under any one of the other valuation methods. He may fund the agreement with insurance, etc.

PRESENTATION OF THE PLAN — PART II

*Joseph Trachtman**

What we are concerned with here is the best way to pass on the wealth of this family, and that includes how to pass it on with the least amount of tax—which means taking advantage of every legitimate opportunity to reduce taxes. But if Mr. Hollingway were interested only in taxes, he could probably sell out all of the assets that he now has for some $300,000 net, driving a hard bargain; then he could put everything in tax-exempt municipal bonds, and on my figures his income would be just about what it is now, net after taxes. He could bequeath half of his estate to his wife outright, and the other half to a charity, or upon trust

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to pay the income to his wife, with remainder to a charity, so there would be no federal income taxes and very little or no federal estate taxes.

There seems to be a complaint that Mr. Evans, 81 years old and living in the Delta, will not tell anyone what he owns. Why should he be expected to do so? Also, there has been emphasis on what we should do if the old gentleman really left a couple of hundred thousand. That, if I were planning this estate, I would look upon as sheer expectancy. It may be that he has lots of money; it may be also that he has not so much.

Our job is to stimulate thought by Mr. Hollingway on two things for which he has had no preparation. First, you are asking him to think about death—he has never thought about death before; he has never died before; he knows he is going to die someday, but the fellow next door is going to die first. Second, you are asking him to think about giving away his property—he has had no experience in giving away property; he has had no preparation for that because all of his life he has been devoting himself to accumulation and hanging on to what he had.

The first question here is whether you should take the marital deduction. If the surviving spouse is very rich, it may be uneconomical to take any marital deduction on the death of the spouse who dies first. What escapes taxation on the first death, by way of the marital deduction, has to be included in the estate of the surviving spouse, and is there pyramided on top of all the other assets of the surviving spouse—and thus exposed to taxation to a higher rate. But here there is no reason to believe that our surviving spouse is going to be a rich surviving spouse unless Mr. Evans comes through with the right amount—and that is uncertain. Mr. Bowe has demonstrated that you can take the maximum marital deduction on these figures and divert from the United States Treasury about $40,000 on the death of Mr. Hollingway— thus the widow would have the income on $40,000 for the rest of her life, and she is the prime object of Mr. *H's* bounty.

We will analyse these income figures a little more. What is more important in these cases? It is not how much capital is going to be left to the family upon the death of the testator, but in what form it is going to be left, how much is there going to be by way of a persistent flow of spendable income? There are not too many assets here that may be counted on to produce that kind of result. The more capital you can divert from the Collector of Internal Revenue, and the more you can put to work for the widow, the better it is. Then, as I will show you later, if Mr. Evans does come through and she does inherit a great deal of money, we can do things to divert from her such extra income and spread it around to the other members of the family. So here, without any doubt whatever, I should say we want the maximum marital deduction.

What sort of assets do we have? The dry goods company may or may not be a one-man operation. It may not produce very much when Mr. Hollingway is dead. The same thing may be true of the bank; the farm property is a speculative property. Of course, it is speculated both ways; they may find oil or uranium on it, too. These are all uncertainties, so my motto is: take the maximum marital deduction on the first estate.

Do not get involved in any doubts about it later. How we will take it, we will talk about when we discuss the will.

Let me now turn to some of the items that seem to me to stand out. In the first place, this man is obviously under-insured. There is only $15,000 of insurance. Mr. Bowe's calculations show that on these figures the liquidity position is not too bad. It is not too bad if these values stand up. (If the values do not stand up the taxes will be lower, too; but there may be more expenses anyway.) The $15,000 of insurance is payable in one lump sum to the wife. If she wants to, she can lend it to the executor to pay taxes, but widows do not always do that. At Mr. Hollingway's present age, 52, if he is insurable, insurance ought to be a good investment for another reason. All of this man's fortune is in equities, farm property, business property—and he has very little in dollars. For the sake of diversification, he ought to have some more dollars even though they are depreciated dollars. Who should own any new insurance? Obviously, someone other than Mr. Hollingway if that is possible. Mrs. Hollingway does not have the money, and you cannot pay premiums out of the expectancy from her father; neither have the children any money. That makes Mr. Bowe's proposal about the inter vivos trust really attractive. Preferred stock of the dry goods company could be given to a trustee, and the trustee could use the income therefrom to pay insurance premiums. It ought not to be on the life of Mr. Hollingway, the settler of the trust, but it ought to be, I suggest, on the life of his wife.

Mrs. Hollingway ought to have some insurance on her life, too. She is at least a $40,000 asset as we have demonstrated. If she survives her husband by one day, you have the marital deduction; if she dies one day before her husband you do not. She is also an asset every March 15 because with her presence Mr. Hollingway can split his income for federal income taxes. Income taxes are more painful and a lot more disturbing to Mr. Hollingway than death taxes.

There is no longer any deduction for property previously taxed in respect of transfers from one spouse to the other. So, if we try for the maximum marital deduction, it will not make much sense if Mary Beth does not live much longer than Mr. Hollingway, because our reasoning is based on her living a long time. We hope she will enjoy for a long time the fruits of that $40,000 that we kept away from the United States Treasury. The arrangement is not so attractive if she does not live very long. If Mary Beth dies one day before her husband there is no surviving spouse and therefore no marital deduction. If she lives one day after his death, you can have the marital deduction. If you are sure that Mary Beth will not have a large estate, you can say in the will that if there is no sufficient evidence as to the order of deaths, all the provisions of the will are to be given effect in like manner as if Mary had survived. That is the way you breathe life into a dead body and produce a surviving spouse for exhibition to the Collector of Internal Revenue. Bear in mind that this can be done only if there is not sufficient evidence as to the order of the deaths; if it is clear that Mary Beth predeceased the testator there can be no marital deduction.

On the other hand—and this might turn out to be a proper case for that—you may say that if she does not live for six months it is to be deemed that she died before her husband. You would do that with a little more positiveness, after Mr. Evans has passed on his inheritance and when you know that she really is rich, for there the initial marital deduction may not loom as big.

Now consider what to do with the dry goods company and what to do with the bank stock. Everybody says that the children and the wife have no interest in this business, but not too much has been said about Mary Beth. She ought to be consulted by the planners much more than she apparently has been. The children are said to have shown no interest or aptitude for either of the businesses, but I am sure that they are interested in the dividends. If the Drakes are allowed to buy the business for $60,000, the Drakes walk out with the business and Mr. Hollingway's estate picks up $60,000—but the $60,000 when invested is never going to produce the kind of income that the dry goods business produced. What is the problem here? The problem really is the personal problem of what to do for the Drakes. It has been assumed that what the Drakes want is a proprietory interest in the business. That is not always so. They certainly do not want a minority interest, not if they stop to think about it. Naturally, they might like to have control. There has been talk about a moral obligation to do something for the Drakes, but I do not understand that there is a moral obligation to give them the whole company. No, what the Drakes may want is more money—some of the profits. And perhaps the best thing is to work out some profit-sharing arrangement. That will probably not cost Mr. Hollingway too much—after taxes—and even if it does cost a little more, in the long run it may be better for the family group. This is a long established business and the Drakes know how to run it—let them run it; make it worth their while to run it even if a minor part of the profits go to the family. It could be that the minor part of the profits, minor though it may be, may be much better than this family can hope to get out of investing $60,000 in the kind of investments that are available to trustees or in which trustees are likely to invest. These suggestions have to be given thought. All this may be true in respect of the bank stock as well.

Now, as to the farm. By itself it is next to the largest item. What is to be done with it? It is sometimes possible not to make specific disposition of particular assets. If it is possible, it is much better to deal with the estate at death as a mass and dispose of it in fractions of that mass. Then it does not matter what is the size of the estate, or what is the nature of the assets, and you can empower the executors and trustees to make fair distribution among the various fractions. It is always well to look at what will be the assets after the administration is over. Here, the small amount of insurance will be gone, and the relatively few investments in Mr. Hollingway's portfolio will be gone, too. And after tax and administrative expenses are paid, even if you take the marital deduction, what is the estate going to consist of?—The farm, the dry goods common and preferred stock, and the bank stock. What should be done with the farm? At Mr. *H*'s death you are going to need all the income in sight to take care of the widow even if old Mr. Evans comes through. Mr. *H*'s

suggestions ought to be set out. He should be encouraged to put his mind on the post-mortem questions as to what is to be done with that farm. Who knows better than he what are the potentialities? Now I do not mean, necessarily, that these notions of his ought to be made mandatory directions in the will. The executors and trustees under the will ought to have a free hand to decide what is best under the circumstances that prevail when action has to be taken, but they ought to know from Mr. *H* while he is alive what are his recommendations.

How else can we plan here to disinherit the Collector of Internal Revenue? We can make inter vivos gifts of capital. You do not have to worry so much now about "contemplation of death." Mr. *H* is only fifty-two and, if he lives three full years after the date of the gift that problem is out. We can find a legitimate motive which is in contemplation of life and we can minimize those factors which could be seized upon to show the gift was in contemplation of death. What assets are there to give? As things stand the only thing that can possibly be given away is the preferred stock. Now, I would not be a bit surprised if Mr. *H* declined to consider gifts, simply on the emotional ground that he does not feel like giving away property. He is only fifty-two. The urge to hang on to property is a very strong urge.

Suppose, however, that Mr. *H* is in a donative frame of mind. Some very interesting questions are presented if it is decided to put the preferred stock in an inter vivos trust. The word "trust", I suggest to you, is now a meaningless term. A trust does not mean anything until you begin to define what kind of trust it is. When you use the word "trust" you put into operation principles of trust law that have been evolved over the centuries in courts of chancery, but they are artificial rules designed to carry out what the law says is the intention of the settlor or the testator, when there is no evidence either way. What is the intention that the law usually attributes to the testator or to the settlor when he is creating a trust? It is an intention that he intends to have strict impartiality between the income beneficiaries and the remaindermen, that the remaindermen are just as much objects of his bounty as are the income beneficiaries, that the trustee is circumscribed by certain fiduciary duties all of which are designed to effectuate that intention, *viz.,* the preservation of the capital intact for distribution in the future—for a later generation. Now that is not going to be our fellow's motivation at all. What is it that Mr. Hollingway would want the trustee to do? He probably would want the trustee to keep that stock intact until Mr. *H* gave the signal to sell it. He wants to call the shots, but if you make him co-trustee, or if you give him the power to direct such retention, you will collide at once with the Clifford Regulations, which will make the income of the trust taxable to him. Probably you will do the same thing if you grant that power to Mary Beth. You have to begin with the proposition that it is best to have a neutral, disinterested trustee to manage the trust. You are under a duty to make clear to Mr. *H* all the possible consequences of putting the preferred shares into a trust.

I would suggest that the trust would subsist during the life of Mary Beth. You would want at least $40,000 of insurance on her life paid for

out of the income of the trust. If she died before Mr. *H* you would have the trustee empowered to lend money to Mr. *H's* estate; if she died after Mr. *H,* her estate would still need the $40,000 because then her estate would include the one half of Mr. *H's* estate which passed to her by way of the marital deduction, and her estate would also probably include the inheritance from her father. In the discretion of the trustee, income should be available to buy insurance on the life of Mary Beth, or on the lives of any of the children of the settlor, or on the lives of their spouses; and to whatever extent the income was not so used the trustee should have power to spread it around to, or for the benefit of, one or more of the persons in that class, or to accumulate it. The trustee should have a free hand. On the death of Mary Beth ordinarily you would want her to have the power to say where the capital should go, but you must look out for something here: If you give her the power to appoint the capital of that trust and if it consists in part of proceeds of insurance on her life, it may be said that you have given her an incident of ownership in the insurance. To play safe it would be well to state that her power of appointment is not exercisable in respect of insurance on her life. On Mary Beth's death, perhaps there could be a division of capital in shares along the lines we will discuss when we talk about the will.

What else could you do with life insurance? Should Mr.*H* own insurance on Mary Beth's life? If he dies first he is the owner of it; the cash surrendered value of it is included in his estate. It is common now to talk about having insurance on the life of the insured owned by someone other than the insured—the wife of the insured, the child of the insured, or somebody else. However, it is often over-looked that the owner of the insurance may die before the insured does. Then, the insurance policy will be in the estate of the owner and there will be the need of continuing the payment of the premiums. All these questions are neatly bypassed by way of a trust—having a trustee own the insurance. So, with all the labor we have gone through, we likely are to end up with only a simple will in this estate plan. The really important planning may well turn on what to do about more life insurance.

EXECUTION OF THE PLAN — PART I

*William J. Bowe**

Under the first paragraph of the will[1] we give to Mary Beth the tangible personal effects. In addition she will receive the life insurance proceeds, the joint bank account, and the jointly owned real estate; these pass outside the will. We decided that we wanted to use the maximum marital deduction—get full benefit of it. We might have put in another paragraph, "I give to Mary Beth the farm," or added other provisions making such gifts to her as we wanted following paragraph one, and we would still use the second paragraph here with the identical phraseology.

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[1]The will is set out in full in the Appendix.

The second paragraph starts, "If my wife, Mary Beth, survives me, . . ." and later on we have a provision that defines what we mean by survivorship. "I direct my executor to set aside a portion of my estate equal in value to (a) one-half of my adjusted gross estate . . ." (Now that is the beginning point in the computation of the marital deduction) ". . . less funeral and administration expenses, and claims and debts but before the deduction of estate or inheritance taxes as finally determined for Federal estate purposes." We had computed this estate on my figures, which appear on Work Sheet No. 2, at $309,000 and assumed $19,000 in debts and administration expenses, so we had an adjusted gross of $290,000. One-half of that (assume those are the values that are fixed for tax purposes) would be $145,000. That is the sum that in (a) of this paragraph we direct the executor to set aside. Then we say *"less* (b) the value of all interests in property, if any, which pass or have passed to my wife under other provisions of this my will or otherwise than under my will." The tangible personal effects have passed and we valued those at $6,000, so it is $145,000 less $6,000. "Or otherwise than under this will"—now otherwise than under this will the joint bank account of $8,000, the residence, and the life insurance passed, so it is less all of those items. The next words are: ". . . but only to the extent that such interests are, for the purposes of the Federal estate tax, included in determining my gross estate." We did not include in the determination of his gross estate the whole value of the jointly owned residence because the wife had contributed $2,000; we included only seven-ninths of that value, and therefore, under (b) we include only seven-ninths. What we do is take the $145,000 and then subtract the $6,000 personal property, the $8,000 bank account, the $15,000 of insurance, and $14,000 of the $18,000 residence. That gets us exactly the amount of the maximum marital deduction because of the next sentence: "All values shall be those finally determined for Federal estate tax purposes." Now that is a clause that could give us trouble, but we must use it if we want to get the maximum marital deduction because we must use the figures ultimately arrived at by the Commissioner.

Assume for the moment that in this will we had given half to Mary Beth and the other half outright to the children, and we had used this clause. Now assume the Commissioner came in and contended the dry goods stock was worth $80,000 instead of $60,000. It would be to Mary Beth's advantage under this clause to agree with the Commissioner because every increase in the value of the stock pushes up the figure we start with under (a). Thus there is an element of danger in this clause. But as I said before, we have here close family harmony. I do not think that Mary Beth is going to try to enrich the Government in order to enrich herself. If she were a second wife and were not on speaking terms with these children, then it might be really hazardous to use the clause, but where we have family harmony we are pretty safe.

The formula simply sets aside an amount of money. Now, how are we going to give that fund to Mary Beth? We can qualify the gift for the marital deduction by either giving it to her outright, or by giving it to her in trust with a general power of appointment, or by giving it to her for life, remainder to her estate. Perhaps because of the nature of the assets in the estate we should have given it to her outright—particularly

the farm. I am doubtful whether a trustee is the ideal manager for the farm, but we put it in trust so that you would get a good illustration of a typical marital deduction trust. We gave Mrs. Hollingway a power of appointment, exercisable only by will. She gets the income for life. In addition she is given the power to withdraw $10,000 a year at her pleasure. Now we might have made that $5,000, or $20,000; we might have given her the power to invade the corpus to any extent she liked. That is a question for Hollingway to decide after he really gets to thinking about these matters. The important thing that we have to do, and the minimum we have to do, is to give her a power to appoint either during life or at death. So, we say: ". . . and upon her death to transfer, convey and pay over the principal to or for the benefit of such person or persons or corporation . . ." (we should add the other words, "or corporations") "in such lawful interests as my wife may by last will and testament appoint." This gives her a general power of appointment. She can appoint it to anybody that she likes and that is enough to qualify the trust provided she is to get the income annually for life.

The next sentence is a default clause. If the power is not exercised, the trustee is directed to convey the property to Hollingway's then living descendants. It is always well to put in a default clause. First, because of a natural inertia; even though Mary Beth has a general power, she may fail to exercise it. Thus the property may well go the way he wanted it to go. In addition, it is an expression of how he would like it to go.

The next subparagraph is important because not all property will qualify for the marital deduction. We have to remember the terminable interest rule. This clause says no property shall be used to satisfy this bequest that does not qualify for the marital deduction. Once you insert that clause your worries about terminable interests are over. The last subparagraph of that paragraph says: "I authorize my wife to renounce this bequest in whole or in part." There may be some doubt whether you can partially renounce under state law without such a provision. Its presence will tend to remind her advisers of the problem at the time when they ought to be deciding whether or not she should renounce the bequest.

Next we come to the residuary gift. All the rest, residue and remainder we give in trust for Mary Beth for her life, and upon her death to be equally divided among the children or the issue of deceased children. There again we might have provided that it be equally divided among the issue of deceased children and spouses of deceased children. Sometimes the testator will want to take care of the son's spouse, as well as the son's children, and sometimes not. I find clients are about equally divided; that is a question for the testator to decide.

We deliberately made the marital deduction bequest subject to tax on Mrs. Hollingway's death in order to get the deduction. We did that by giving her the general power. Now we want to be sure this residuary bequest is not going to be subject to tax on her death. We gave her a life estate, remainder to the children. We might have given her a special power to appoint the fund to and among the children. We might have given her, under the Powers of Appointment of 1951, a power to with-

draw $5,000 a year or 5 per cent of the corpus without having it regarded as a general power. We might have given her power to demand sums from the trustee in excess of 5 per cent, where needed to maintain her accustomed standard of living, and not have subjected the corpus to taxation on her death. Under the 1951 Act, the special power can be very broad. It seems to me there is no point in making it broader than indicated by the particular facts, and I have been relying somewhat more than Mr. Trachtman on Joe Evans' death and the receipt of a substantial fund, so I have not worried too much about Mrs. Hollingway.

Under the fourth paragraph we have authorized the trustee to pay to the current income beneficiary from principal any amounts that he in his discretion deems wise. If Mary Beth ever gets to the point where she needs money—where she has exhausted her $10,000 withdrawal privilege each year from the first trust—the trustee has a discretionary power to give her whatever part of the corpus of this non-marital deduction trust that he wants.

Now to go back a little, on the death of Mary Beth we direct the trustee to pay out to the issue of the deceased children their shares of the corpus. The shares of the living children we keep in trust until each attains twenty-one. Now I want to call your attention to (b): "To hold one such part as a separate trust . . ." In the earlier paragraph we told the trustee to divide the fund into as many parts as there were children or issue of deceased children, and to hold each such part as a separate and distinct trust. I can create a trust of $100,000 and have the income divided equally among my three children. I have created one trust and each child has a third interest. On the other hand, if he holds each share as a separate and distinct trust, we have three trusts even though each trust may own an undivided third of the assets held by the trustee. Now the advantage is this: If a few years after the creation of the trust we sell an asset which cost us $40,000 for $70,000, we have a $30,000 long-term capital gain and $15,000 is subject to income tax. If we have three separate trusts (even though created by the same instrument) each has a one-third interest in the asset sold and we have three gains; instead of one gain of $30,000, we have three gains of $10,000. Of course we save money if $5,000 is taxed three times at a lower rate rather than $15,000 being taxed once at a higher rate. It is always important to create separate and distinct trusts.

Paragraph seventh deals with gifts to infants. Some of these issue may be under twenty-one, and that is a typical paragraph used to enable the trustee to continue the management of the fund (even though it vests immediately in the child) until the child reaches twenty-one; it avoids a guardianship.

Paragraph eighth is the tax clause. Every will should contain a tax clause. The amount—the tax bite—is so great that if it falls in the wrong place it can ruin the client's whole plan. The importance of a tax clause throwing that burden where the client wants to throw it cannot be overemphasized. You can put the burden anywhere you like. Here we put it against the residue because we do not want to diminish the marital deduction. If any part of the taxes are chargeable against the marital

deduction, that automatically decreases the amount of the deduction. The marital deduction is only what actually goes to the widow. So we say "all estate, inheritance, legacy, succession taxes, etc., imposed by any domestic or foreign laws." Occasionally wills read "with respect to all property passing hereunder." The draftsmen have forgotten that the proceeds of life insurance may be subject to tax, and that gifts may be subject to tax because of retained powers or because given in contemplation of death. To cover this we provide "all property taxable at my death, whether or not such property passes under this, my will, and whether such taxes be payable by my estate or any recipient, shall be paid by my executor out of my residuary estate." The federal statute requires that life insurance bear its share of the taxes and frequently the testator would rather not have the life insurance diminished that way. It is extremely important, because of the high rates, to question the client closely as to where the tax money is to come from, and then be sure to get it down in a tax clause. Wherever you want the maximum marital deduction, be certain that the marital deduction share does not bear any part of the tax.

Now the subparagraph of item eighth is an authorization to the executor to file a joint return. The federal income tax law permits the executor to file a joint return with the widow and thereby get the benefit of splitting. Executors are very hesitant about doing that without permission because they may subject themselves to a tax burden. If the executor signs with the wife and later it appears there was some fraud on the part of the wife in the return, the executor is equally liable for the fraud penalties. His mere signature makes him liable for the entire tax and any adjustments that may be made, so he is putting himself out on a limb. He will not do it unless you authorize him.

Paragraph ninth deals with the customary trust powers.

The only other provision I want to call to your attention is paragraph thirteenth—the survivorship clause. Here it is the reverse of what we traditionally did. In the past, we always said "if my wife and I perish in a common disaster, it shall be deemed that I survived her." Today, if we have a case where the husband has $200,000 and the wife nothing, and they die together, we want to be sure that we have done everything to have his death presumed to have occurred prior to hers; that is the only way to get the marital deduction. Under the regulations when you cannot determine from the facts who died first, then a presumption created by the instrument will control. If the Hollingways perished in a common accident, and you cannot tell who died first, his estate under the will momentarily will go to Mary Beth; he will get the marital deduction, and then it will pass on from Mary Beth with very substantial tax savings.

EXECUTION OF THE PLAN—PART II

*Joseph Trachtman**

Professor Bowe suggests that most of my fears of the use of formula clauses do not have any significance in this case because there is marital harmony. But the trouble is that these clauses are used thoughtlessly in almost every case and some of the difficulties that they can create cannot be settled with all the family harmony in the world. First of all, what do I mean by a "formula clause", and before that, what is it that we are really trying to do by this will, having decided that we want to get the maximum marital deduction.

You want to make sure that there will pass to the widow at least one-half of the adjusted gross estate. That is the gross estate minus the familiar deductions for funeral and administrative expenses and a few other items like casualty losses. Sometimes the problem is to make sure that you get at least one-half of the adjusted gross estate over to the widow, and other times the problem is to pass one-half but not any more than one-half. In other words, sometimes the object is precision and other times you do not care whether it is so precise as long as you obtian at least the maximum. When is it that you want this precision? You want it only when the surviving spouse is expected to have, or does have, a very substantial estate, because what escapes taxation on the first death is only exposed to taxation in the second estate, and if the second estate is going to be large we do not want to swell it. We do not want to augment it by giving the surving spouse more than one-half of the first adjusted gross estate. The federal tax rates are peculiar. They go up gently; then they come to a sort of plateau; sometimes they even dip down before they begin to rise again; so this factor really does not make much difference unless the two estates are well above the range of $200,000 or $300,000. Even if Mr. Evans does give Mary Beth everything you will not get her estate up much above that $300,000 or $200,000 range, even if you give her a little more than the maximum marital deduction.

How do we go about trying to achieve precision in these cases where we want precision? When he fills out Form 706, the federal tax return, the executor comes to Schedule M, the schedule in which he writes down all the items which are in his judgment qualified for the marital deduction. Under this will he would put down $15,000 of insurance; he would put down the value of the jointly owned dwelling, if it stays in joint ownership; and he would put down the value of the tangible personal effects. Then on a separate piece of paper he will make a computation of what his adjusted gross estate is. He will say half of it is so much, and he will then add up these three items that he has down on the schedule so far, and he will say, "I'm short so many dollars." The clause in the will directs the executor to put down the precise difference so that the last item in Schedule M makes up the maximum marital deduction. What this really amounts to, in the cases where there is doubt as to the size and composition of the

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adjusted gross estate, is to give the Collector of Internal Revenue a power of appointment to decide how much is to go under this clause of the will. I do not like to give the Collector a power of appointment; it produces even greater uncertainty. I admit that in this case these fears are unjustified, but the formula clauses are very troublesome in those situations where there is uncertainty about the size and composition of the gross estate. The argument is we do not know what the testator is going to leave; we do not know what the Collector is going to include in the gross estate. The testator may have made some gifts in contemplation of death, or which the Collector says were made in contemplation of death, or there may be some transfers which it will be determined were transfers to take effect in possession or enjoyment at or after death, or he may receive assets just one day before he draws his last gasp. All this is cloudy and uncertain. Therefore, we must try to write out a clause which is self-adjusting and meets every situation. It has been a long time, if ever, since you could write a will that was so self-adjusting that you could put it away in a safe deposit box and forget it. Wills have to be reviewed periodically.

There are two kinds of these clauses. By the first kind you give to the surviving spouse a general legacy, a legacy of a sum of dollars either outright or in trust. You spell out whatever is required to pass to her the amount needed to get precisely the maximum marital deduction and no more. A general legacy has priority, and therefore, if between the date of death and the time for the distribution of the estate there has been a very sharp decline in the value of the assets comprising the estate, the general legatee comes out ahead of the residuary legatee—indeed there may not be any residuary. And the opposite may come to pass—the assets may go up in that interval and the residuary estate will be relatively much larger than the general legacy. All this becomes important where one segment of the estate goes to the surviving spouse at the testator's death and another segment then goes to others like children or collaterals.

Another objection to using the general legacy is that if the testator distributes assets in kind to the general legatee in satisfaction of the legacy, which assets have increased in value between the date of death and the date of distribution, the Commissioner says that the executor has realized a capital gain. Let us say that the legacy is $50,000. The executor delivers to the legatee stocks that are worth $50,000 at the time of distribution, but the stocks that he used were worth only $35,000 at the date of death. The Commissioner says that is precisely as if the executor had sold those stocks and had realized a capital gain of $15,000. If the interest of the beneficiary is not that of a general legatee, if he is the recipient of a fraction of the residuary estate, no capital gain is realized by the executor upon the distribution of the securities. The beneficiary has always been entitled to whatever fraction it is of the whole estate. There has been a rise in value but the beneficiary has not realized it until he sells what he has received.

It may be that the testator has already provided for the surviving spouse, substantially, outside the will. He may have made much life insurance payable to her, a great many assets may have been passed to her as the surviving joint owner, or gifts may have been made to her that are in contemplation of death. If that is so, then very little will pass to the surviv-

ing spouse under the will. The will says in one way or another: ascertain how much must be given to the surviving spouse to obtain the maximum marital deduction, then deduct from that amount what has already passed to her outside the will and under the other clauses of the will, and give her the difference under the will. However, if so much has passed to her outside of the will that very little is to go to her under the will, you will have given the surviving spouse less than her statutory portion, and she can claim against the will. I understand that in Mississippi the widow's statutory portion in this case would be a child's share, which would be one-fourth. Therefore, on these calculations and by this language, would she be getting one-fourth? She does not take anything outright under this will outside of the personal effects. She has an estate for life, an equitable life estate in whatever is required to give her the maximum marital deduction here. She also has a general power to appoint, and a power to draw up to $10,000 a year. Whether all that would add up to her statutory portion under Mississippi law, I don't know. Here then is something else you have to consider as a result of a formula clause.

These formula clauses are very difficult clauses to draw, and it is difficult to foresee what they will lead to. I think, without intending any offense to anyone, they are beyond the competence of the average practitioner. My theory about writing wills is that you ought to use orthodox methods. No word should be used in a will unless you are absolutely certain as to how it is going to work. I might be willing to take risks of one kind or another for myself, but I do not think it is right for me to take risks with the property of my client; especially when there is no need for it.

Usually, I suggest that the residuary estate should be as close as possible to the adjusted gross estate. You achieve that by having no general legacies ahead of the residuary estate. If this testator, for instance, had given one-half of the residuary estate to Mary Beth outright, or upon this trust, where would you be as regards the marital deduction? You would have given her a little more than half of the adjusted gross estate, because she would have picked up the $15,000 life insurance and the jointly owned property. All that, however, comes to something less than $30,000 and on these figures I do not think that can make much difference. Remember, all these figures are in a sense guesses anyway; you do not know if they are going to be correct fifteen years from now or not.

Suppose that the advice that I gave here had been taken, namely, that there should be more life insurance on Mr. Hollingway's life. Suppose that instead of $15,000 of life insurance, there were includible in the gross estate policies that added up to $100,000 of life insurance. If all the insurance was payable to the widow, then my approach so far would be substantially out of line. She would have half of the residuary estate; she would have all the $100,000 of life insurance. But it need not be so. What you would do then would be to split the life insurance. You qualify one-half of the proceeds, and you would not qualify the other half. That is done very neatly and very simply. You say as to half of the proceeds that she takes it outright or she takes it under options with power to say that the unpaid principal remaining at her death shall be payable to her administrator or executor. That half of the life insurance proceeds is then qualified for the marital deduction. The other half you make payable to

her under the same options, if that is desired, but you would not give her the power to direct the payment of the unpaid principal to her estate—that half is not qualified for the marital deduction. Or you could make the insurance payable to the trustee to divide the fund into two separate and distinct trusts. One of these trusts would be qualified by giving her the income and a general power of appointment over the capital, and the other separate and distinct trust would not be qualified. There is nothing to the problem so far—you can have precision and you can have it without unorthodox language. You split the life insurance, and you split the residuary estate—each on a fifty-fifty basis.

But it will be said, what about the jointly owned property? In this case the jointly owned property is not worth very much, relatively. Suppose, however, that the farm were jointly owned, or suppose that Mr. Hollingway and his wife have a lot of other jointly owned property—your figures would be out of kilter because she would be receiving the value of the jointly owned property, and that would be too much surplusage over the half that you want to give her. There are two things to do. First, these joint ownerships are often expensive for taxpayers. Sometimes the thing to do is tear apart the joint ownerships and, if necessary, pay some gift tax to do so; put some of the items in the name of the husband and some in the name of the wife. If that is not feasible, then you would say, in dividing the testamentary residuary estate into two equal segments, that the jointly owned property shall be brought into hotchpot, treated as if it were owned by the testator, and deducted from the first half. That is the same as if you said, "I want half of my estate to go to Mary Beth on my death, but if she picks up some life insurance and jointly owned property—I want the values thereof to be treated as part of my estate and counted against what I give her under this will. The half which I give her by this will is to be diminished by the sums which she takes under those transfers." All that is orthodox drafting without the jargon of the Code. It results in much simpler administration because the executor is dealing with one-half of the estate or some other definitely stated fraction. You do not have the many problems that you have when you become involved in the formula clause. You will not know, if you use one of these formulas, exactly how much passes to the widow, and how much passes to everybody else, until the Collector of Internal Revenue has said the last word on the audit of the federal estate tax return. This may mean a lapse of several years; sometimes the last word will not have been said until the Supreme Court says it some Monday morning, and then it may not be the last word.

Do the formula clauses violate the rule against incorporation in the will of the language of the Internal Revenue Code as it will stand at the date of his death? Is there a violation of the rule against perpetuities because, until the audit of the federal estate tax return has been completed, no interest can be said to have vested and that it is a period not measured by lives in being plus twenty-one years. These are ridiculous arguments. I would be the first to say, but a lawyer in Detroit told me "I'd like to take my hand at shaking the tree a little bit with some of these arguments as ammunition." Maybe he could shake off a few plums, too.

You may say that the testator will want to remember some persons by way of general legacies, he may want to give the Drakes a legacy. If you

put such legacies ahead of the residuary clause then your calculations will be out of kilter, too. If such legacies were to be provided, you would say, "My residuary estate shall be divided into two equal shares; called the First Part and the Second Part, respectively. (I do not say "half" but I say "part," because I may have adjustments to make that will make the shares unequal and not halves.) The First Part I devise and bequeath to my wife (if that is the way it is to be, or to a trustee upon trust terms that qualify for the marital deduction.) The Second Part I dispose of as follows: I bequeath $1,000 to John Smith payable out of the Second Part, and $5,000 to John Doe, payable out of the Second Part." In other words, you pay out of the Second Part these general legacies, and you direct the payment of all death taxes out of the Second Part, too. So again, simply by using ordinary time honored methods of drafting, you will be obtaining exactly what everybody thinks he is getting by these more complicated, and I think, experimental clauses.

I have not said anything so far about the "fractional clauses." These are the clauses that provide: if my wife survives me I give to my trustee that fraction of my residuary estate which will produce the maximum marital deduction. Those clauses, I think, are dreadful. Nor do I think those clauses will always achieve the maximum marital deduction because in those clauses it is always provided that the determinations in the federal estate tax proceedings shall "control". These clauses say, if my wife survives me I give my wife a fraction of my residuary estate—ascertain what is the maximum marital deduction, how much of it has to be passed to the widow by the will, then if it is, say $100,000, and that is one-fourth of the estate, you give to the wife one-fourth. It never works out so easily. It is always a fraction with three or four digits after the decimal point. In making all these calculations the testator says that the determinations in the federal estate proceedings shall control. The executor has for distribution an estate in his hands in accordance with the accounting practices that are passed in the court in which he acts. The Collector of Internal Revenue has a series of figures for a different kind of estate. It is the same decedent with the same assets, but they have different points of view. For instance, the estate may be much larger on the executor's side or it may be much smaller. The executor pays a debt of $50,000 in complete good faith and pursuant to a court order and shows the deduction for estate tax, but the Collector can contend that debt is not a valid debt. The estate in the hands of the executor for distribution may be an entirely different thing than the estate that appears on the records of the Collector—and this may be so not merely because of rise or decline in value. I pointed out that the executor might pay debts and administration expenses which are disallowed by the Collector—but the executor has paid that money out, he does not have it. Therefore, the amount in his hands for distribution is less than the amount that appears on the federal audit.

The estate in the executor's hands may be larger than it is on the Collector's audit. The testamentary estate may include foreign real estate. Our testator may have taken a flyer in Venezuela or Canadian oil land that will be a part of the residue, but will not be subject to federal estate tax. Our testator may also have property over which he has a power of appointment which is not taxable because under the Powers of Appoint-

ment Act of 1951 it is not a taxable power, but he may have blended it in with his residuary estate. Therefore, he will give, by operation of the fractional formula share, more to the surviving spouse than he wants to for tax purposes.

Mr. Bowe relies here on a power in the wife to renounce this bequest in whole or in part. What he has in mind is that she may have a great deal more property at her husband's death than we contemplate now, because her father may have died and given her a part of his fortune, or she may have acquired other assets—then it would not be wise for her to take so much by way of marital deduction. I am not sure what the power to renounce this bequest means. If this were an absolute legacy or devise to her outright, then I would not have trouble with it. She has only income and a power to appoint. What happens to the property over which she has a power of appointment? Should it say she has the power to renounce that, too? Maybe if she renounces this bequest it will be held that she has a power only to renounce the income which is payable to her and not the power of appointment. This has to be spelled out, I think, much more; provision for renunciation of life insurance proceeds, making it clear where the renounced proceeds shall go, is also useful.

The residuary estate here is not intended to qualify for the marital deduction; so all the income goes to Mary Beth, and she does not have a power of appointment in respect thereto. This was on the theory that she might inherit property from her father and therefore we would not want to have this property included in her estate. I suggest that you might not want the income included on her personal income tax return either; so if I were trying to anticipate a very heavy inheritance on the part of Mary Beth, I would say that the income of this trust during her life is to be distributed as the trustee from time to time deems wise, but only to or for the benefit of Mary Beth or one or more of the descendants of the testator or spouses of such descendants. If she became very rich and did not need this income, it could be passed on to other members of the family group who were not so well off and whose tax returns were not so painful.

Then the provision is that the share of a child is to be held in trust until the child attains thirty-five years. When the child attains the age of thirty-five, he or she takes the share. If he or she dies under thirty-five, his or her share goes to his or her issue. I would give each of these children the power to appoint the capital of his share if he died under thirty-five. Take the son, for instance—He is a mechanical engineer and married, and if he attains the age of thirty-five and dies one day later his will would make provision for his wife, or she would take her share by intestacy. If he dies one hour before he attains the age of thirty-five, his share goes to his children and his wife is at the mercy of her own children. If this boy attains the age of thirty-five one day before his mother dies. his wife gets no part of Mr. Hollingway's estate because the share that would have been set aside for him at his mother's death is set apart for his children.

In appropriate cases, one could give the children power to appoint shares that would prospectively be set apart to them on the death of their mother. All this can be done without attracting any federal estate tax

in the estates of the children because the donee only has to be forbidden to apoint to his own estate, or his creditors, or the creditors of his own estate—people to whom he would not think of appointing anyway.

The shares of infants here are directed to be set apart under powers in trust. We have to do that in New York because of our peculiar rule against perpetuities, but you do not have to do it here because you have the common law rule. So, I would not have made any distinction between the share of grandchildren and the shares of Mr. Hollingway's own children. I would put all such shares in trust until the life beneficiary attained the age of thirty-five years, and then I would have a saving clause which said that no trust should subsist longer than twenty-one years after the death of the survivor of Mr. Hollingway's children, and further provided that if any trust terminated by operation of this saving clause the capital thereof should thereupon go to the person who would then otherwise be entitled to receive the income of that trust.

There is a power here in the trustee to give principal to, or for the benefit of, any person who is currently entitled to income. I think that needs to be spelled out with a lot more care. What is a trustee to do? Is he to take into account the other resources of the income beneficiary? The trustee is always a trustee for remaindermen as well as income beneficiaries, and I think that it ought to be spelled out whether he is to take into account or to disregard other interests and resources of the beneficiary.

There is a useful power here to permit the executor to join with the testator's wife in filing income tax returns for periods prior to death. There is now another option that an executor has to consider. An executor can elect whether administration expenses are to be taken as deductions on the executor's income tax return, or whether he should take such items as a deduction on the estate tax return. If the estate tax rates are low, or comparatively low, because of the marital deduction and perhaps because there is some charitable deduction, a deduction of say $25,000 for administrative expenses does not mean much on the estate tax return. However, if the income of the estate is high it does a lot more good to take such item as a deduction on the executor's income tax return. The executor is in a dilemma if he takes it as a deduction for income tax; that deprives the remaindermen, who are the persons upon whom falls the burden of the estate tax, of the benefit of that estate tax deduction, and yet the $25,000 is paid out of the capital. The executor might be given power to determine where the deduction is to be taken, and also power to make an adjustment between the conflicting interests. This is discussed in the 1952 Report of the American Bar Association Committee on Drafting Wills and Trusts, printed in the October issue of *Trusts & Estates* magazine.

Finally, we come to the "simultaneous death" clause. It may be that you do not want the presumption that is here set forth. There has been much talk about Mary Beth inheriting a large estate. If she does inherit a large estate you may still want the marital deduction, because you want to give her the benefit of the tax which is saved on the death of the testator during her life—that would be on the assumption that she will live that long. But you might want to say that if she does not live for six months all of the dispositive provisions of the will are to be given effect in the like

manner as if she had predeceased the testator, because then the bet is not as attractive as it is if she lives for a long while. This is another example of why you can never put a will down and say, "Now this is self-adjusting; this can be forgotten." Wills have to be reviewed periodically.

THE PROBATE OF THE WILL

*Thomas Y. Minniece**

From the legal standpoint the probate of this will[1] ought not to give a whole lot of difficulty. Therefore, I am going to devote just a few minutes to talking about the probate of the will, and then I am going a little further by going into the administration of the estate. I am going to look at it more from the position of the bank which has to handle this estate and these two trust estates, rather than from the legal technicalities involved.

The first question that might arise in reference to this will is, where is the will? We do not have any information as to with whom the will was left. It could be left in a lawyer's office and he might not have been paid his fee for drawing it; he might not want to give it up until his fee is paid. If that question arises, we have a statute under which you can bring him into court and compel him to produce the will.[2]

Then the second question that might arise would be, is this the last will and testament of Mr. Hollingway? It was drawn on the day he died according to the facts we have, and most likely it would be the last will that he wrote; so we should not have any difficulty in that regard. Another question that sometimes arises with regard to wills is whether it is actually a will or, as lawyers say, is it testamentary in character or is it a deed? This was obviously drawn as a will and I do not think we have any trouble in that respect.

We have certain requirements about the witnessing of the will. It has to be witnessed by two creditable witnesses in the presence of the testator and in the presence of each other.[3] Our courts have held that the testator does not actually have to sign it in their presence, but he has to make a statement to the witnesses that he signed it. We do not have any witnesses shown on this will, but I presumed that in getting the will executed they were going to get two witnesses. Of course, if he had written it entirely in his own hand-writing then it would not have made any difference,[4] but since it appears to be a type-written will it would be necessary to get two witnesses to attest to the will. It is possible that those witnesses might be disqualified if they were beneficiaries under the will.[5]

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[1]The will is set out in full in the Appendix.

[2]MISS. CODE, § 497 (1942).

[3]MISS. CODE, § 657 (1942).

[4]See note 3 *supra*.

[5]MISS. CODE, § 661 (1942). But see also § 662 which allows a creditor of the decedent to be a competent witness.

Then the question would be is the will valid under the laws of Mississippi? Well, the answer to that is that it would be valid. The statute of mortmain[6] that is, the part concerning gifts to charitable organizations is not necessary to give the children anything if you do not feel like it, although a number of people have the idea, to the contrary, that children have to be included in a will. You even see a number of lawyers drawing wills that give each one of the sons $1 or $5 because they think that it might be necessary. The only exception to that would be a case in which a child was born after the making of the will, and the will did not include it or specifically disinherit such child. The reason for that is that the law presumes that you would have made a provision if you had known about it.

We have a statute in Mississippi that provides that no party who willfully kills a testator shall take under the will.[7] So, if the sudden and violent death of J. Richard Hollingway had been brought about by his wife shooting him that morning, then she would not have been able to take under this will. I am also of the opinion that this trust would be interpreted as a taking under that will, and because she would be disqualified, that part of the estate would go intestate.

The will must be probated before it has any effect and the question comes about as to how to probate it. As I said, that is a relatively simple matter in Mississippi: It can be probated before the clerk of the court by proving the will. It can be probated in what we call common form or in solemn form. The only difference is that when you probate a will in solemn form you make all the interested parties parties to the probate, and you serve process on them just as if you were suing them. In a case like this, that would be an advantage because you have certain trusts to be set up and administered. If you do not bring these people in and make them parties, they have the right to contest the will any time within two years, or in case of minority or disability, two years after their disability has been removed.[8] That would make it a rather indefinite proposition, and since you want to get these trusts set up and operating, you want to bring them in as parties. However, there is a simpler method than probating it in solemn form, if you can get them all to agree, and that is to get them to join in a petition to probate the will.

The next question would be whether or not the Union Bank, which was named as executor of the will, is qualified to act. Under our statutes,[9] I can not see any reason why it should not be.

Then the question comes about as to what the bank is going to do after they get the will probated. That is a question, not so much of probating the will, as of administering the estate. Judge Amis wrote a book called the *Duties of Executors, Administrators, and Guardians.* It was written to be distributed to laymen, banks, individuals, or anyone who is

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[6]Miss. Code, § 671 (1942).

[7]Miss. Code § 672 (1942). § 479 also prevents such person from taking in cases of intestacy.

[8]Miss. Code § 505 (1942).

[9]See Miss. Code § 511 (1942), for qualifications of an executor.

administering an estate or guardianship. It is written for the layman and is written in layman's language. I recommend it to you for your use if you have a number of estates to be administered.

The statutes of Mississippi are rather liberal in following wills. There is no reason, that I can see, in most respects, why this will cannot be followed as it is written, insofar as the executor is concerned. There is one item I want to call attention to later, in which it cannot be followed under certain circumstances. An administration of an estate is really in the nature of a receivership. It is a liquidation proceeding. It is not for the purpose of carrying on a business, but for the purpose of liquidating the business to pay the debts and to distribute the money. A lot of people do not understand why they have to administer the estate and go to the expense of getting a lawyer and all that. There are creditors of these estates, and they have a right to get paid. Many times they say: "Oh, he didn't owe any debts," but when you get around to publishing notice to his creditors, you find out that he did. Those creditors have a right to be protected, and that is the reason the law requires administration of these estates. The best rule to follow generally in administering the estate is that if you are in doubt about anything, go to the chancellor and get his authority to take care of it. The duties of an executor include hiring competent counsel. No layman can proceed in administering an estate without a competent lawyer. The rules of the court require that you do it, and they require further that you can not change your attorney without permission of the court. That is to keep you from going to get another lawyer when this lawyer advises you that you cannot do something that you ought not to do.

Another rule that you ought to remember, and remember well, is that you cannot deal with this property personally. The trust officer who is handling the bank stock might decide it has to be sold, and since he is willing to pay more than anybody else, he will just buy it himself. The best advice on that is: Do not do it. Under the laws of Mississippi, if you do, all that a party seeking to invalidate the sale would have to show is that you held the position of trust officer; then the burden is on you to show that you went out and got independent advice about that sale. In any fiduciary capacity in which you serve, the best thing to do, regardless of how much you have to sacrifice property and how much more you are willing to pay for it than anybody else, is not fool with it.

In this particular estate, it looks as if one of the dangers and pitfalls that you are liable to fall into first is that you might not keep these estates separate. There are two different trust estates set up here and an executorship, and all of those are three different entities. The only way to keep them straight is to set them up separately and keep separate accounts. There will be a temptation here, since the same bank is handling all of them, not to separate them. That is something that might cause a whole lot of trouble later.

The first emergency proposition that might affect the bank would be the question of insurance. The insurance should be checked to see that he carried insurance on this property; that the proper endorsements are made so that it will be paid to the executor, and then later to the trustee.

The laws require, ordinarily, that an inventory of the estate be made and then an appraisal. This will waives an inventory which waiver is valid under our laws, and waives a bond which waiver is valid; however, it does not waive an appraisal, and you cannot very well appraise the property without listing it. The appraisers are ordinarily supposed to set off the exempt property and the widow's allowance. In this case, there is a clause by which she foregoes all that, which is a definite election with her. You will not need the exempt property set aside. You will not need the widow's allowance.

The question then arises as to what property is the executor to administer? Under our laws, the real property is not ordinarily a concern of the executor. It passes immediately under the will. Of course, in this case it would pass to the trustee. The personal property is the only thing the executor is concerned with, and the only exception being where there are so many debts that you have to sell the real property to pay them, which does not seem likely here. There is an exception that the growing crops and rents for the first year can be handled by the executor. However, we had a case in Mississippi styled *Gaines vs. Klein,*[10] which holds that this is only true if the rent for that first year and growing crops are necessary to pay debts. That case holds further that under the will, not only the property passes, but the income from that property. This will provides that the debts will be paid out of the residuary clause of the will. The trust that is set up for the wife is exempted from all administrative expenses. All inheritance taxes will be paid out of the residuary estate. Now that means that as to whatever property is ultimately decided to go to that trust, not only the principal of that property, but whatever income is earned after his death goes into that trust. The question arises as to what goes into the residuary estate. The executor has the right to the personal property, and if needed the rent for the first year and the growing crops. As to the growing crops, the executor has to make an option. He would either have to go ahead and harvest the crop, or he can sell it. If he harvests it, he may have to advance money or credit. If he does, and there is a crop failure, he can not call on the balance of the estate to pay it; he is going to have to pay that out of the bank funds.

There is no going business that the testator appears to be in, except this partnership. This, of course, is designated as a limited partnership. As far as administration of this estate is concerned, it appears to me that that partnership is going to have to be administered just as if it were a general partnership, that is, in respect to its liquidation. We have a statute which provides that any limited partner can force the dissolution of the partnership by the same means that he could if it were a general partnership.[11] Death could terminate the general partnership; therefore, I am of the opinion that it would terminate this limited partnership. The obvious thing to do would be to sell it, which you can do, if the other limited partners or the general partners will pay what it is worth. If they try to freeze you out and not give you anything for your interest in the partnership, then you do either one of two things. You may liquidate it, in which

[10] 203 Miss. 508, 34 So.2d 489 (1948).
[11] Miss. Code § 5566 (1942).

case the general partner would have the first right to handle it. If he does not do it, the executor has that job also. That is another thing that has to be kept separate; it is a separate proceeding and a separate liquidation. This is one point where a waiver of a bond does not do any good; they would have to put up a bond to liquidate the partnership, and that bond would have to be enough to cover the whole partnership, not just enough to cover the executor's part of it. They would then proceed to liquidate that partnership. The debts of the partnership are first paid out of these assets.

Then the executor would have to collect the debts and life insurance. The life insurance probably would not give any trouble.

The next thing the administrator ordinarily would have to do would be to sell the personal property. The will gives very broad powers in that regard. Anything that is collected from this, of course, has to be deposited in the bank. The executor has the duty of paying the taxes later, and I want to call your attention to the *Millsaps* case[12] which provides that the situs of the property for certain taxes is at the domicile of the trustee. That means this bank in Jackson who we have assumed has taken over is not only going to have to pay state and county ad valorem taxes, but they are going to have to pay municipal taxes to the city of Jackson which are likely to run a bit higher than they would have in the town of Jefferson. After the estate is closed and the trustees take over, the personal property is taxable in Jackson.

The executor will next have to pay the debts of the estate including all the expenses of administration. Funeral expenses and the cost of a monument can be paid without being probated. Those are expenses that arise after his death. You need to get the chancellor's approval for that, but they do not have to be probated. Debts that arise before he dies have to be properly probated, and if you pay them without their being properly probated you can be surcharged and held liable personally for those debts.

In my opinion that furniture might give a little trouble. It would certainly be questionable as to whether or not furniture would be included in the tangible personal effects which were given to his wife. In that case, the wife might find herself without furniture. Of course, the obvious thing to do would be for the executor to sell that furniture to her, as she probably would not want to part with it. I do not believe it would pass under that provision of the will, and it would certainly be questionable. The automobile might be the same way, of course.

The next clause I want to comment on is in reference to renunciation of the will. It should be a little bit more specific as to just what she can renounce. I do think that the provision that she can renounce part of it would be valid under our law. There is no reason why the will could not provide that she could renounce part of it if she wanted to, but I think it ought to be a little bit more specific as to whether that is income or principal, since this property does go to the trustee.

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[12]Millsaps v. Jackson, 78 Miss. 537, 30 So. 756 (1901).

I would like to bring up also the eleventh clause which provides that, "I appoint the Union Bank of Jackson, Mississippi, its successor or successors by any merger, conversion or consolidation, Executor of this my Last Will and Testament and Trustee of the trusts hereby created." I can not find any provision in the will as to who will administer this estate or who will administer these trusts if the Union Bank of Jackson does not want to do it. If they do not, of course, the court will not allow the trust to fail. They will appoint a trustee, but under the law that trustee is not given the same power that is given in this will. There is no provision that does that, and the law would presume that the testator did not have the same confidence in this trustee as in this bank, and this list of powers that they gave the trustee would just fail. I think there should be some provision for other trustees if this trustee refuses to take it.

APPENDIX*

WORK SHEET #1

THE FACTS

I. *Mr. Hollingway's Family.*

Mr. Richard Hollingway of Jefferson, Mississippi, aged 52, is married and the father of three children. Mr. Hollingway is the sole owner of the Jefferson Dry Goods Store and is president of the First National Bank of Jefferson. He owns a 10 per cent stock interest in the bank and also has an interest in a local ginning company. His wife, Mary Beth, is aged 50. They were married in 1923, and their three children have now reached the following ages: Martha, 29; Robert, 27; Joan, 24. Martha has never married, but has remained at home with her mother and father. Martha graduated from Jackson Business College, Jackson, Mississippi, in 1946, and has since been employed as a secretary to Joseph Falls, owner of the Falls Feed Company in Jefferson. Her present salary is $200 per month. Martha has dated various boys in town, and at one time was engaged to Forrest Short, a young man who had once managed a drug store in Jefferson. She broke the engagement in 1949 when Short quit his job, joined the Air Force, and left town.

Robert has been quite successful since he returned from serving with the Navy in World War II. When Robert graduated from Jefferson High School in 1944, he joined the Navy as an Apprentice Seaman. By the time of his discharge in 1946, he held the rate of torpedoman, third class. In that year, Robert entered Rensselaer Polytechnic Institute, Troy, New York, on the G. I. Bill, and by attending all summer sessions, he was able to complete his course in Mechanical Engineering by August, 1948. In January, 1949, Robert visited a former Navy friend in Schenectady, New York, who introduced him to the Personnel Manager of the General Electric Company. When offered a job as Mechanical Engineer with G. E., Robert decided to take it, although he hated to be so far away from home. In 1950, Robert met Susan Polasek, at the G.E. Christmas party. Although Robert has "gone steady" with a number of different girls before meeting Susan, he had never fallen deeply in love. With Susan it was different, and they were married at her home in Amsterdam, New York, in April, 1951. In May, 1952, they had their first baby, James R. Hollingway, II. Mr. and Mrs. Richard Hollingway have never met their daughter-in-law, and are not presently planning a trip up North. Robert has wanted to visit his folks in Jefferson, but has not been able to raise the money to spend on the trip.

Joan has always been her father's favorite. When she graduated from Jefferson High, Mr. Hollingway made every effort to send her to college. As a result, she entered the University of Mississippi in 1946. She majored in sociology, and was a member of Kappa Kappa Gamma sorority. In 1950, she managed to graduate, despite a rather poor college record. Since her high school days, Joan has "gone with" Will Eggers. Will, who is the same age as Joan, was too young for World War II. He attended Mississippi State College for two years, but finally quit. After that, he tried selling insurance, but without any particular success. When Joan came home to Jefferson after graduating from Ole Miss, she started to date Will once again. In 1951, Will asked Joan to marry him, but she turned him down. In June 1952, however, Joan

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*Editor's Note—In addition to the Work Sheets found in the Appendix, copies of the following named papers were also distributed at the Conference: Estate Questionnaire, Petition for Letters Testamentary, Decree ordering Probate of Will and Appointment of Executor, Proof of Will, Notice to Creditors, and a Schedule showing the Federal Estate and Gift Taxes and the Mississippi Inheritance Tax.

Reprints of the following named articles were also distributed: Wren, *Congress and the* Church *and* Spiegel *Cases,* 21 Miss. L. J. 223 (1950); Wren, *Taxation of Transfers in Satisfaction of Marital Rights: A Note on* Harris v. Commissioner, 22 Miss. L. J. 212 (1951); Spinney, *The Trust Officer,* 323 Ins. L. J. 749 (1952).

changed her mind, and the two of them were finally married in September 1952. Since that time, Will has quit the insurance business, and Mr. Hollingway has turned over the management of his farm properties to him. He pays Will a salary of $3000 per year, and also gives him the use of the entire farm, including the old farm house.

Mr. Hollingway's wife, Mary Beth, comes from one of the well-known Delta families. Her father, James D. Evans, is still living. He makes his home in Leland, Mississippi. He is now 81 years of age. Mary Beth has one brother, John Evans, who has lived in Chicago for over twenty-five years. John is 48 years old. Mary Beth believes that if her father left a will, he would give his property to John and herself in equal shares. Although John has had little contact with his father during the last twenty-five years, she knows no reason why her father would want to disinherit him. Unfortunately, it is almost impossible to find out the size of Mr. Evans' estate. Estimates range anywhere from $200,000 to $500,000. Mr. Evans will not permit anyone to look into his own affairs, and he has several times refused to permit his attorney to prepare an estate plan for him. Not only is it next to impossible to determine the value of Mr. Evans' estate, it is equally difficult to determine just what assets Mary Beth would receive should her father die and leave her some, or all, of his property. For his age, Mr. Evans is in very good health. At 81, he has remained active in the community at Leland where he is a prominent member of the Presbyterian Church, as well as an active member of the Leland Rotary Club.

II. *Mr. Hollingway's Assets.*

1. FARM PROPERTY. In 1932 Mr. Hollingway purchased his farm at $10 an acre. The acreage at the time of purchase was 1200 acres and it has remained that since the original purchase. The buildings on the porperty, consisting of a farm house, barn, silo and one or two other small out-buildings, cost $3000. Thus, the total cost in 1932 was $15,000. Since that time Mr. Hollingway has improved the farm extensively, having spent $10,000 on improvements. The fair market value of the property today is $90,000. For the past five to ten years Mr. Hollingway's farm has produced from fifty to sixty bales of cotton from which he realizes income of $175 a bale or a total of $8750 to $10,500. When real property taxes are deducted from this amount, Mr. Hollingway has been able to realize a net income from the farm of between $8000 and $9750 a year.[1]

2. STOCK OWNERSHIP IN FIRST NATIONAL BANK. At various times since 1923 when he joined the bank, Mr. Hollingway has acquired a total of a hundred shares of the bank's stock, par value $100. Mr. Hollingway has expended a total of $13,000 in acquiring this stock, or $3000 over par value. The present fair market value of the bank stock is $30,000. Dividends on the bank stock for the past ten years have averaged $12 per share per annum, giving Mr. Hollingway an annual dividend income of $1200. In addition Mr. Hollingway is paid a salary of $3600 a year for his services as president of the bank. Although Mr. Hollingway keeps a close eye on the banking business, in the past he has left the management of the bank in the capable hands of Mr. Will Beck, vice president and trust officer. Mr. Beck owns twenty-five shares of the bank stock. The 475 shares of the bank's stock not owned by Mr. Hollingway or Mr. Beck is owned by individuals in Jefferson and elsewhere in lots of ten shares and less. For all practical purposes management of the bank is entirely in the hands of Mr. Hollingway and Mr. Beck.

3. LOAN TO JOHN EVANS. In 1947 Mary Beth received a letter from her brother, John, saying that he had suffered some very serious illness in his family and asking her if she would lend him some money. At the request of Mary Beth, Mr. Hollingway loaned her brother $5000 at 6% payable on demand. Mr. Evans has paid the interest on this note of $300 a year regularly, but to date has made no attempt to reduce the principal.

4. INSURANCE. In the past Mr. Hollingway has been reluctant to purchase any insurance. In 1927 he took out an ordinary life insurance policy with his wife as beneficiary of face amount of $15,000. As it was a twenty-year payment policy the

[1]This does not include the $3000 salary paid to Will Eggers.

insurance has been fully paid up since 1947. To date Mr. Hollingway has taken out no additional insurance.

5. HOUSE. Mr. Hollingway bought his present home in 1923 in the City of Jefferson for $4000. At that time Mr. James D. Evans gave his daughter, Mary Beth, $2000 to help in the purchase of the house. The deed was drawn to Mr. and Mrs. Hollingway as joint tenants. Since 1923 Mr. Hollingway has expended approximately $5000 on improvements on the house and in 1949 he was offered $18,000 if he would sell the house.

6. BANK ACCOUNT. Mr. Hollingway has not kept a savings account but customarily keeps approximately $8000 in his checking account in the First National Bank, this account being in the names of "J. Richard and/or Mary Beth Hollingway."

7. JEFFERSON GIN COMPANY. The Jefferson Gin Company is organized as a limited partnership under Sections 5553-5570 of the Mississippi Code. Mr. Hollingway is one of sixteen limited partners. The business is managed by Mr. Thomas Condon who is the only general partner. Mr. Condon's interest in the business has a fair market value of approximately $30,000. The interests of the sixteen limited partners have a fair market value of approximately $4000 each.

8. JEFFERSON DRY GOODS STORE. Mr. Hollingway's father, Thomas Hollingway, died intestate in 1933, leaving Mr. Hollingway as his sole heir. The principal asset in his father's estate consisted of the entire capital stock of the Jefferson Dry Goods Store, a Mississippi corporation, of which Thomas Hollingway had been the sole owner for nearly forty years. The management of the dry goods store since the death of Thomas has been in the hands of Randall Drake who went into business with Mr. Hollingway's father as a young man thirty-seven years ago. Mr. Drake is now sixty-three years old and has always resented the fact that despite his extreme loyalty to Thomas, since old Mr. Hollingway died without a will, he has never been able to acquire an interest in the business. Mr. Drake does not even have a position on the board of directors of the corporation. He has the title of general manager. The board of directors is composed of Mr. Richard Hollingway, Mary Beth Evans Hollingway and Miss Lulu Jones, Mr. Hollingway's secretary at the store. These same persons also hold the titles of president, vice president and secretary-treasurer of the corporation respectively. This corporate organization, however, is largely formalistic and for all practical purposes the business is operated as though it were a proprietorship with Mr. Hollingway the sole owner. Mr. Hollingway devotes approximately 70 per cent of his working time to the store. The rest of his time is spent at the bank. Randall Drake, Jr., age 36, has been associated with the store since 1946 when he was discharged from the Army. His present position is that of assistant general manager with a salary of $3800 a year. Like his father the younger Mr. Drake has no interest in the business. On occasion Richard has thought that perhaps he should recognize his father's moral obligation to Drake but as yet he has done nothing to compensate Mr. Drake other than to pay him an annual salary of $7300 a year. The Jefferson Dry Goods Store has been extremely profitable in recent years and its stock presently has a fair market value of $110,000 as compared with a fair market value of $32,500 as of the date of the death of the elder Mr. Hollingway.

9. INVESTMENTS. Mr. Hollingway has a diversified portfolio of securities consisting largely of good common stocks. He also has a number of municipal bonds and some United States War Bonds, Series G.

In 1937 Mr. Hollingway drew a will in which he left his entire estate to his wife. Neither Mr. Hollingway nor his wife has used any portion of his gift tax exemption. Recently Mr. Hollingway heard of the marital deduction provided by the Revenue Act of 1948. Accordingly he visited with his attorney, Mr. Ralph Landrum, who has instructed his junior partner, Mr. Walter Dunham, Jr., to acquire all the factual data with reference to Mr. Hollingway's estate and family. The data contained herein is a result of Mr. Dunham's investigation.

INVENTORY

Assets	Date Acquired	Cost or Other Basis	Funds for Purch. From	Title Held (How?)	Fair Market Value	Annual Income
Personal Effects	Various	$ 300	Income	in JRH	$ 300	
Home Furnishings	"	3,000	"	" "	3,000	
Automobile (1950 Olds)	1950	2,900	"	" "	2,200	
Home	1923	9,000[1]	JRH 7,000 MBH 2,000	joint tenancy JRH &/or MBH	18,000	
Checking Account (average)	Various	8,000	Income	in JRH	8,000	
Loan to John Evans	1947	5,000	"	" "	5,000	$ 300
Life Insurance	1927	9,500	"	" "	15,000[3]	
Farm Property	1932	25,000[2]	"	" "	90,000	5,875
First National Bank Stock (100 shares)	Various	13,000	"	" "	30,000	1,200
Jefferson Gin Co. (limited partnership interest)	1938	2,500	"	" "	4,000	3,600[4] 200
Jefferson Dry Goods Store	1933	32,500	Inheritance	" "	110,000	21,000[5]
Stock Portfolio	Various	17,889	Income	" "	18,286	813
Municipal Bonds	"	5,045	"	" "	5,130	115
War Bonds—Series G	1944	4,000	"	JRH &/or MBH	4,000	60
		$137,634			$312,916	$33,163

1. Cost ..... $ 4,000
   Improvement 5,000
   Total ..... $ 9,000
2. Purchased at foreclosure sale from John Small, farmer, @ $10 per acre 1200 acres, or total of $12,000, plus farm buildings $3,000. Improvement equal $10,000.
3. The face amount of the policy. Cash surrender value is $8900.
4. Bank salary.
5. Salary—$9,000; Dividends—$12,000.

JEFFERSON DRY GOODS STORE

Balance Sheet[1]

Dec. 31, 1952

ASSETS

Current Assets:			
Cash		$ 10,000	
Accounts Receivable	$ 10,250		
Less: Reserve for Doubtful Accounts	250		
			$ 82,000
Merchandise Inventory		10,000	
Fixed Assets:		62,000	
Furniture & Fixtures	$ 7,500		
Less: Reserve for Depreciation	2,500	$ 5,000	
Building	$ 50,000		
Less: Reserve for Depreciation	20,000	30,000	35,000
Prepaid Expenses			1,000
Total Assets			$118,000

LIABILITIES AND NET WORTH

Current Liabilities:			
Accounts Payable	$ 5,000		
Notes Payable, Due 1953	8,000	$ 13,000	
Fixed Laibilities:			
Notes Payable, Due 1955	$ 4,000		
Mortgage, Due 1958	6,000	10,000	
Total Liabilities			$ 23,000
Capital Stock:			
6% Cum. Pfd., par value $100			
500 shares	$ 50,000		
Common Stock, no par value,			
4000 shares	40,000		
		$ 90,000	
Earned Surplus		5,000	95,000
Total Net Worth			
Liabilities and Net Worth			$ 118,000

[1]Goodwill (not taken up on the books of account) is estimated at $15,000 on the basis of an offer to purchase the business in the amount of $110,000. Such offer was made to Mr. Hollingway by Mr. Cahill Stone.

JEFFERSON DRY GOODS STORE

Statement of Profit and Loss for the Year Ended Dec. 31, 1952

Sales Income		$ 308,000	
Cost of Goods Sold:			
Inventory, Jan. 1	$ 60,000		
Purchases During Year	198,000		
	$ 258,000		
Inventory, Dec. 31	62,000	196,000	
Gross Profit			$ 112,000
Sales Expenses:			
Sales Salaries	$ 26,000		
Advertising	14,000	$ 40,000	
Administrative Expenses:			
J. Richard Hollingway, Salary	$ 9,000		
Office Salaries	17,000		
Taxes	6,000		
Insurance	7,500		
Depreciation, Furnit. & Fix.	500		
Depreciation, Bldg.	1,000	41,000	
Financial Expenses:			
Interest Paid		1,080	
Total Expenses		$ 82,080	
Financial Incomes:			
Interest Received		80	82,000
Profit before Fed. Income Tax			30,000
Federal Income Tax			15,600
Net Profit for the Year			$ 14,400

Earned Surplus:			
Balance, Jan. 1		$ 2,600	
Add Net Profit for the Year		14,400	$ 17,000
Less: Dividends			
Preferred Stock—$6 per share		$ 3,000	
Common Stock—$2.25 per share		9,000	12,000
			$ 5,000

STOCK AND BOND PORTFOLIO[1]

	Date Acq.	Cost	No. of Shares	Purch. Price Per. Sh.	F.M.V. Per. Sh.	Total F.M.V.	Annual Income
STOCKS:							
American Can	1940	$ 1,487.50	50	29¾	35½	$ 1,775.00	$ 70.00
Gulf States Util. $4.40 pfd.	1946	7,840.00	70	112	103	7,210.00	308.00
Youngstown Sheet & Tube	1949	1,680.00	35	48	44¾	1,576.25	105.00
Southern Pacific	1949	1,691.25	30	56⅜	48¼	1,447.50	90.00
M-K-T pfd.	11/6/52	1,490.63	25	59⅝	68½	1,712.50	
Sherwin-Williams Co.	4/10/53	1,500.00	20	75	69½	1,390.00	60.00
Amer. Tel & Tel	1937	2,200.00	20	110	158¾	3,175.00	180.00
		$17,889.38				$18,286.25	$813.00

	Date Acq.	Cost	Face Amt.	Purch. Price	Market Price	F.M.V.	Annual Income
BONDS:							
Jackcon School Dist. 2¼s due 1973	1949	$1,050	$1,000	105	102½	$1,025	$ 22.50
Tupelo BAWI 3s due 1980	1946	530	500	106	107	535	15.00
Hattiesburg 2s due 1977	1952	1,990	2,000	99½	101¼	2,025	40.00
Greenville Levee Dist. 2½s due 1960	1945	1,425	1,500	95	103	1,545	37.50
		$4,995	$5,000			$5,130	$115.00

WORK SHEET #2

PRELIMINARY STUDY AND RECOMMENDATIONS

Residence (owned jointly with wife, 7/9 of value included)	$ 14,000
Cash on Deposit	8,000
Life Insurance, face value	15,000
Farm Property	90,000
Bank Stock	30,000
Interest in Jefferson Gin Mill	4,000
Jefferson Dry Goods Co. Preferred	50,000
Common	60,000
Stocks	18,000
Bonds	9,000
Notes	5,000
Misc.	6,000
	$309,000

1. *Valuation.* Exact dollar amounts have been disregarded in the interest of simplicity.

a. 7/9 of the jointly owned residence included as Mr. *H* contributed $7,000 of the total $9,000 cost.

[1]All fair market value prices are based on closing prices, March 14, 1953.

b. Insurance included at its face value as Mr. *H* owns policy and paid premiums.

c. There may be some question as to the accuracy of the value placed upon the Bank Stock, the Residence, the Dry Goods Stock and the Farm Property. Variations in the Bank Stock and Residence will not be significant. From my little knowledge of farm values, ten times earnings with owner operation seems fair. Similarly five times earnings for a Dry Goods Business, such as Mr. *H's* is in line with customary capitalization practices. The accuracy of this latter valuation is substantiated by the recent offer to purchase the business.

2. *Liquidity.*

Cash	$ 8,000
Life Insurance	15,000
Stocks	18,000
Bonds	9,000
	$50,000

3. *Estate Taxes*

a. If Mr. *H* survives Mrs. *H* or fails to use the marital deduction—

Gross Estate		$309,000
Less Adm. Exp. and debts	$19,000	
Exemption	60,000	79,000
Net Taxable Estate		$230,000
Federal Estate Tax	$57,800	
Mississippi Estate Tax	4,880	
Adm. Exp. and debts	19,000	
	$81,680	

b. If Mr. *H* predeceases Mrs. *H* and uses marital deduction, his federal estate tax will only amount to $16,140. Mississippi estate tax and administration expense will remain the same. His estate appears amply liquid to take care of this.

c. To what extent he should use the marital deduction is difficult to determine since the amount of Mrs. *H*'s inheritance from her father is unascertainable. It seems fair to assume it will not be less than $150,000 and that she will receive it outright, either by will or intestacy. If she survives her father and Mr. *H*, use of the marital deduction by Mr. *H* would increase the death taxes on Mrs. *H*'s death by $45,000 (state and federal) but its use will have reduced the taxes on Mr. *H*'s estate by $40,000. One factor, however, to consider is that the use of the marital deduction delays the payment of the excess tax until Mrs. *H*'s subsequent death giving her the use of the additional capital. Also she will have opportunities to make gifts after his death. And lastly she may be authorized to renounce a part of her bequest following his death if this seems desirable at that time. For these reasons use of the marital deduction is recommended.

4. *Gifts to children.* At Mr. *H*'s comparatively young age there would not seem to be any real incentive to make substantial gifts. In view of his wife's likely inheritance there would be no point in his making gifts to her. Gifts to the children, free of gift tax, may be made up to $78,000 but we would suppose under all the circumstances he would not wish to part with 25 per cent of his wealth.

We would suggest that he consider the creation of an irrevocable life insurance trust. He would transfer, free of gift tax, his $50,000 of preferred stock in the Dry Goods Co. to a corporate trustee under an instrument creating three separate and distinct trusts, one for each of his children. The trustee would be instructed to use the income to purchase insurance on the lives of the children. Such a step would:

a. Save estate taxes on his death;

b. Incur no gift tax, even though it is a gift of a future interest;

c. Save income taxes;

d. Relieve the children of the burden of carrying insurance;

e. Free the proceeds from estate taxes on their deaths even though the insurance proceeds may be made available to meet their death costs.

The estate tax saving on Mr. *H*'s death without the marital deduction would be about $15,000, with it about $8,500.

The yearly income tax saving by removing $3,000 from his 53-56 bracket to the trustee's 22.2 bracket would amount to $1,020. Further, if the preferred stock of the Dry Goods Co. should ever be redeemed the capital gain would be spread among three tax entities.

5. *Jointly owned residence.* Consider what, if anything, should be done with this property. It has an income tax cost basis of $9,000. Giving it to his wife would not involve much of a gift since, because of her longer life expectancy, she already owns slightly more than half. It would remove the property from his estate but Mrs. *H*'s would be saddled with the low cost basis. On the other hand she could give her interest to him and on his death obtain a new cost basis. Their gift tax exemptions and the gift tax marital deduction would make either transfer free of gift tax, even if he gives the children the recommended $50,000.

6. *Bank Stock.* In view of the fact that his children have no interest in the Bank Stock it might be possible to arrange a stock redemption agreement with the Bank under which his holdings will be redeemed at his death. Recent amendments to Section 115 make these plans much more attractive than formerly. As an alternative his associate might be willing to enter into a stock purchase agreement to buy this stock at Mr. *H*'s death. The advantage of either plan is that it may be so drawn as to fix the estate tax value of the stock.

7. *Dry Goods Co.* Like the Bank Stock, his stock here is of value to him because of his interest in this business. But his children have shown no inclination to undertake the management of this enterprise. Further, he feels an obligation to his manager, Mr. Drake. The ideal solution would seem to be a stock purchase agreement with Drake Sr. and Jr. This will create a market for the stock, assure a fair price and, if not exercised until Mr. *H*'s death, will fix the value for estate tax purposes. To avoid a large capital gain tax, sale should be on the installment plan or be delayed until after Mr. *H*'s death.

SUMMARY

1. *Will*—use marital deduction and non-marital deduction trusts for benefit of wife. Give her power to partially renounce. Upon her death, if she fails to exercise her powers of appointment, equally to the children.

2. *Life Insurance Trust.* These can be put into operation immediately.

3. Meanwhile further discussions will be had with the Drakes and with the Bank officials concerning the ultimate disposition of these assets.

WORK SHEET #3

THE WILL

I, J. Richard Hollingway of Jefferson, Mississippi, do hereby make, publish and declare this to be my Last Will and Testament, hereby revoking all Wills heretofore made by me.

FIRST: I give and bequeath my tangible personal effects to my wife, Mary Beth.

SECOND: If my wife, Mary Beth, survives me, I direct my Executor to set aside a portion of my estate equal in value to (a) one-half of the value of my adjusted gross estate (gross taxable estate less funeral and administration expenses and claims and debts but before the deduction of estate or inheritance taxes) as finally determined for Federal estate tax purposes, less (b) the value of all interests in property, if

any, which pass or have passed to my wife under other provisions of this will or otherwise than under this will, but only to the extent that such interests are for the purposes of the Federal estate tax included in determining my gross taxable estate and allowed as a marital deducation. All values shall be those finally determined for Federal estate tax purposes.

I give, devise and bequeath the said portion of my estate to the Trustee hereinafter named, IN TRUST, NEVERTHELESS, to hold, manage, invest and reinvest the same, to collect the income, and to pay over the net income in quarterly installments, to my wife, Mary Beth, during her life, and to pay out of the principal to my said wife such sum or sums, from time to time, as my said wife shall demand in writing, but not exceeding the sum of ten thousand dollars (10,000) in any one calendar year, and upon her death to transfer, convey and pay over the principal to or for the benefit of such person or persons or corporation, and in such lawful interests or estates, whether absolute or in trust, as my wife may by her Last Will and Testament appoint. If the power of appointment is for any reason not validly exercised by my wife in whole or in part, then upon her death such portion or all of the principal of the trust or such interests or estates therein as shall not have been validly appointed by her shall be transferred, conveyed and paid over to my then living descendants, per stirpes.

Notwithstanding anything to the contrary contained in this will, I direct (a) that in establishing this trust for my wife there shall not be allocated to the trust any property or the proceeds of any property which would not qualify for the marital deduction allowable in determining the Federal estate tax on my estate and (b) that the Trustee of this trust shall not retain beyond a reasonable time any property which may at any time be or become unproductive nor shall they invest in unproductive property.

I authorize my said wife to renounce this bequest in whole or in part.

THIRD: All the rest, residue and remainder of my property of whatsoever kind and wheresoever situated, I give, devise and bequeath to the Trustee hereinafter named, IN TRUST, NEVERTHELESS, to hold, manage, invest and reinvest the same, to collect the income and to pay over the net income, in quarterly installments, to my wife, Mary Beth, during her life; and upon the death of my said wife, if she shall survive me, the Trustee shall divide the then principal of this trust (but if my said wife shall have predeceased me, then upon my death, the executor shall divide my residuary estate) into as many equal parts as there shall be children of mine then living and children of mine who shall have previously died, leaving issue then living, and in respect of said parts my Trustee or Executor, as the case may be, is directed:

(a) To assign, convey and pay over one of such parts in equal shares to the then living issue, per stirpes, of each such deceased child of mine.

(b) To hold one of such parts as a separate trust for the benefit of each of my children then living, and to manage, invest and reinvest the same, to collect the income, and to pay over the net income, in quarterly installments, to such child for whom such part shall be held in trust during his or her life; provided, however, that, upon such child attaining the age of thirty-five (35) years, the Trustee shall assign, convey and pay over to him or her, as the case may be, the full amount of the principal then held in trust for such child; but upon the death of any such child, prior to attaining thirty-five, the trust in respect of his or her part shall terminate and the Trustee shall assign, convey and pay over the principal of the part then held in trust for the benefit of such child, in equal shares to the issue of such child then living, per stirpes, and, if none, to his or her brothers and sisters then living and the issue of any deceased brother or sister, per stirpes.

FOURTH: I authorize and empower my Trustee to pay over to any current income beneficiary out of the principal of any of the trusts hereby created for his or her benefit, at any time and from time to time, such sum or sums as the Trustee, in its sole and absolute discretion, may determine.

FIFTH: The provisions herein made for my wife, Mary Beth, are to be accepted by her in lieu of all dower and other rights which she may have in my estate.

SIXTH: As used in this my will the terms "child," "children," "issue," "descend-

ant," and" decendants" are intended to include any person adopted by me, by any child or descendant of mine and his descendants.

SEVENTH: (a) If any part of my estate shall be payable to an infant, then and in such event, I give and grant to my Trustee a power in trust, in each such case, to take possession, hold, administer, invest and reinvest such part of my estate for such infant's benefit during his or her minority, to collect the income and to pay over the net income, if it shall so elect, to the legally appointed guardian of such infant, or the Trustee may, at its election, apply so much of the net income and principal as it shall deem necessary for the suitable support, education, and maintenance of such infant. The Trustee shall accumulate any unexpended income during the minority of such infant and pay over all net income so accumulated together with the principal to such infant if and when he shall attain the age of twenty-one (21) years; but if such infant should die before reaching the age of twenty-one (21) years, the net income so accumulated and the principal shall be paid to his estate.

(b) I direct that any and all rights, powers and privileges granted in this my Last Will and Testament to the Trustee hereunder, as well as any and all directions herein contained, shall apply to the administration, investment and reinvestment of any and all assets held by it under the power of trust granted to it under subparagraph (a) of this paragraph Seventh.

EIGHTH: All estate, inheritance, legacy, succession of transfer taxes (including any interest and penalties thereon) imposed by any domestic or foreign laws with respect to all property taxable under such laws by reason of my death, whether or not such property passes under this my will and whether such taxes be payable by my estate or by any recipient of any such property, shall be paid by my Executor out of my residuary estate as part of the expenses of the administration thereof with no right of reimbursement from any recipient of any such property.

I direct my Executor to join with my wife in filing joint income tax returns for any period prior to my death and to pay out of my residuary estate all of the taxes found to be due with respect to such returns.

NINTH: I hereby expressly authorize and empower the Executor with respect to my estate and the Trustee with respect to each of the trusts herein created, in its sole and absolute discretion:

(1) To purchase or otherwise acquire, and to retain, whether originally a part of my estate or subsequently acquired, any and all stocks, bonds, notes or other securities, or any variety of real or personal property, including stocks or interests in investment trusts and common trust funds, as they may deem advisable, whether or not such investments be of the character permissible for investments by fiduciaries.

(2) To sell, lease, pledge, mortgage, transfer, exchange, convert or otherwise dispose of, or grant options with respect to, any and all property at any time forming a part of my estate or of the trust estates, in such manner, at such time or times, for such purposes, for such prices and upon such terms, credits and conditions as it may deem advisable. Any lease made by the Executor or by the Trustee may extend beyond the period fixed by statute for leases made by fiduciaries and beyond the duration of the trusts.

(3) To borrow money for any purpose connected with the protection, preservation or improvement of my general estate or of the trust estates whenever in its judgment advisable, and as security to mortgage or pledge any real estate or personal property of which I may die seized or possessed or forming a part of the trust estates upon such terms and conditions as it may deem advisable.

(4) To vote in person or by general or limited proxy with respect to any shares of stock or other securities held by it; to consent, directly or through a committee or other agent, to the reorganization, consolidation, merger, dissolution or liquidation of any corporation in which my estate or the trust estates may have any interest, or to the sale, lease, pledge or mortgage of any property by or to any such corporation; and to make any payments and to take any steps which it may deem necessary or proper to enable it to obtain the benefit of any such transaction.

(5) To hold investments in the name of a nominee.

(6) To complete, extend, modify or renew any loans, notes, bonds, mortgages, contracts or any other obligations which I may own or to which I may be a party or which may be liens or charges against any of my property or against my estate, although I may not be liable thereon, in such manner as it may deem advisable; to pay, compromise, compound, adjust, submit to arbitration, sell or release any claims or demands of my estate or the trust estates against others or of others against my estate or the trust estates as it may deem advisable, including the acceptance of deeds of real property in satisfaction of bonds and mortgages, and to make any payments in connection therewith which it may deem advisable.

(7) To make distribution of my estate or of the principal of the trust estates in kind and to cause any share to be composed of cash, property or undivided fractional shares in property different in kind from any other share.

(8) To execute and deliver any and all instruments in writing which it may deem advisable to carry out any of the foregoing powers. No party to any such instrument in writing signed by the Executor or by the Trustee shall be obliged to inquire into its validity, or be bound to see to the application by the Executor or by the Trustee of any money or other property paid or delivered to it pursuant to the terms of any such instrument.

TENTH: Dividends on shares of stock payable in the stock of any class of the corporation declaring or authorizing the same shall be treated as principal, except that any such dividends paid in lieu of periodic cash dividends or in lieu or recoupment of dividends defaulted or accumulated while the shares of stock are held in my estate or in any trust estate shall be income.

Rents, royalties and cash dividends received from wasting assets (including without limitation cash dividends paid by oil, coal, lumber or mining companies), extraordinary cash dividends other than liquidating dividends, and dividends payable in the stock of a corporation other than the corporation declaring or authorizing the same shall be income.

The proceeds of the sale of unproductive or underproductive property, liquidating dividends, and rights to subscribe to stock shall be principal.

No sinking fund shall be created as to any security received or purchased at a premium or at a price in excess of the call or redemption price.

ELEVENTH: I appoint the Union Bank of Jackson, Mississippi, its successor or successors by any merger, conversion or consolidation, Executor of this my Last Will and Testament and Trustee of the trusts hereby created.

TWELFTH: I direct that the Executor shall not be required to file any inventory of my estate and that no Executor or Trustee shall be required to give any bond, and if, notwithstanding this direction, any bond is required by any law, statute or rule of court, no sureties be required thereon.

THIRTEENTH: If my wife shall die simultaneously with me or under such circumstances as to render it difficult or impossible to determine who predeceased the other, I hereby declare that my wife shall be deemed to have survived me and that this will and all of its provisions shall be construed upon that assumption and basis.

FOURTEENTH: To the extent that the same is permitted by law, none of the beneficiaries hereunder shall have any power to dispose of or to charge by way of anticipation any interest given to such beneficiary; and all sums payable to such beneficiaries hereunder shall be free and clear of the debts, contracts, alienations and anticipations of the beneficiaries, and of all liabilities for levies and attachments and proceedings of whatsoever kind, at law or in equity.

FIFTEENTH: Throughout this will the masculine gender shall be deemed to include the feminine and the singular the plural, and vice versa.

IN WITNESS WHEREOF, I, J. Richard Hollingway, have to this my Last Will and Testament, consisting of six pages, subscribed by name and set my seal this ..... day of May, in the year of Our Lord One Thousand Nine Hundred and Fifty-Three.

.....(L.S.)

Subscribed and sealed by the Testator in the presence of us and of each of us, and at the same time published, declared and acknowledged by him to us to be his Last Will and Testament, and thereupon we, at the request of the said Testator, in his presence and in the presence of each other, have herunto subscribd our names as witnesses this ..... day of May, 1953.

..... residing at .....
..... residing at .....
..... residing at .....

WORK SHEET #4

THE SHORT TERM TRUST

THIS AGREEMENT executed in duplicate at Jefferson, Mississippi, this 2nd day of May 1953, between JAMES RICHARD HOLLINGWAY of Jefferson, Mississippi (hereinafter called "Donor") and the FIRST NATIONAL BANK OF JEFFERSON, MISSISSIPPI, (hereinafter referred to as "the Trustee"),

WITNESSETH:

That the Donor does hereby transfer, convey and deliver to the Trustee, and the Trustee does hereby, by the execution of this Agreement, acknowledge receipt from the Donor of the property described in Schedule "A" hereto attached, which, together with any property hereinafter transferred and delivered, subject to the trusts hereby created, to the Trustee by the Donor, or by any other person hereinafter collectively termed the trust estate) shall be held upon the following trusts:

ARTICLE I

In the investment, administration and distribution of the trust estate the Trustee shall have the following rights, powers and limitations:

(a) The Trustee shall not have the authority to loan any funds to the Donor or anyone else except upon receiving adequate security for same and charging the going interest rate for the type of loan made.

(b) The Trustee shall not have authority to transact any business with the Donor, directly or indirectly, excepting upon terms it should require as a fiduciary exercising the highest degree of care in an arms-length transaction with a stranger and shall not act for the purpose of advancing the interests of the Donor excepting as same may be coincidental to the primary benefit of this trust.

(c) The Trustee shall not have authority to own or pay the premiums on any life insurance contract on the life of the Donor.

(d) Subject to sub-paragraphs (a), (b) and (c) above, the Trustee shall have the rights and powers to
[Here the client's attorney should set forth the specific powers to manage and control the property being placed in the trust that he deems best, being careful not to contravene the limitations set forth in sub-paragraphs (a), (b) and (c).]

(e) The Trustee shall be paid reasonable compensation out of the trust for its service hereunder, and shall also be reimbursed from said trust for all reasonable expenses incurred in the management and protection thereof.

ARTICLE II

The Trustee shall accumulate and invest the net income from the trust estate in a fund separate from the trust estate on the basis of the same rights, powers and limitations as are set forth in Aricle I above for the investment and administration of the trust estate. In addition to the rights and powers set forth in Article I above the Trustee is hereby authorized but not directed to apply for and be the sole owner

and beneficiary of a life insurance contract upon the life of Robert Hollingway, son of the Donor; any such contract to be of the type issued by Lamar Life Insurance Company, Jackson, Mississippi, and described as "Special Ordinary with Extra Deposits to make 10 Pay Life," and the Trustee shall allow the dividends on any such contract to accumulate unless the Trustee deems it best to apply same in reduction of premiums.

The premiums on any such life insurance contract shall be paid from the net income derived from the trust estate. The balance of the net income, if any, shall be accumulated and invested by the Trustee as a fund separate from the trust estate.

If at any rate the net income derived by the Trustee from dividends and the trust estate shall be insufficient to pay the premiums on any such life insurance contract held hereunder, the Trustee shall promptly notify the Donor, in writing, of the amount necessary to pay such premiums and the Donor shall have the right if he so elects to transfer to the Trustee a sum sufficient to pay such premimums. Any such sums transferred by the Donor shall not be regarded as part of the trust estate as heretofore defined, but shall constitute a contribution which shall not revert to the Donor. It is understood that unless the net income of the trust, together with sums furnished by the Donor, are sufficient to pay all premiums on any insurance held hereunder, then the Trustee shall be under no obligation to pay such premimums or any of them and shall not be liable to any extent whatsoever in case such premiums are not paid. The Trustee is also authorized (but not obliged) to convert any such insurance contract, in event it is unable by reason of insufficient funds to pay the premium, into a paid-up contract in whatever amount may be provided by the terms of said contract.

ARTICLE III

This trust shall terminate ten years and one month from the date hereof or one month after the date of death of Robert Hollingway, whichever is the earlier in point of time.

In the event Robert Hollingway is living upon the termination of this trust then the Trustee shall:

(a) transfer, convey and deliver to Robert Hollingway all income of the trust accumulated and/or accrued during the term of this trust, together with any life insurance contract purchased on the life of Robert Hollingway by the Trustee, and

(b) transfer, convey and deliver to the Donor all of the trust estate as then constituted, it being the purpose of this trust that the Donor shall receive back only the principal of the trust estate and it being expressly understood that the Trustee shall not distribute to the Donor or the Donor's estate at any time any of the earnings or income of this trust.

In the event Robert Hollingway is not living upon the termination of this trust then the trustee shall:

(a) collect the proceeds of any life insurance contract carried on the life of Robert Hollingway and,

(b) transfer, convey and deliver any such proceeds, together with all accumulated and/or accrued income of this trust to Martha Hollingway, daughter of the Donor, if living, and if Martha Hollingway is not living then to the heirs of Robert Hollingway (excepting the Donor who shall be regarded for purposes of this sub-paragraph (b) as having predeceased Robert Holingway), and,

(c) transfer, convey and deliver to the Donor the trust estate as then constituted, it being the purpose of this trust that the Donor shall receive back only the principal of the trust estate and it being expressly understood that the Trustee shall not distribute to the Donor or the Donor's estate at any time any of the earnings or income of this trust.

In the event the Donor is not living at the termination of this trust then the trust estate as described above shall be distributed to his then living heirs per stirpes as though he had died on the date of the termination of this trust.

ARTICLE IV

This trust shall be known as the Robert Hollingway Trust and all conveyances and transfers of property hereto shall be made to the First National Bank of Jefferson, Mississippi, Trustee of the Robert Hollingway Trust.

ARTICLE V

No income or principle, including life insurance proceeds, distributable under the provisions of this instrument shall be transferable or assignable or be in any manner liable, while in possession of the Trustee, for the debts or obligations of any beneficiary.

ARTICLE VI

This trust is irrevocable. The Donor shall not have any right to alter, modify or amend the terms hereof.

ARTICLE VII

The Trustee may resign at any time but such resignation shall not be effective until thirty days after written notice has been given to the Donor if he is living, or, in the event of his death before the end of such thirty-day period until thirty days after notice to Robert Hollingway. Upon such resignation a successor trustee may be appointed by the Donor during his lifetime, or, after his death by the Donor's surviving spouse, or after her death by any court having jurisdiction over the trust. The Donor may not be a successor trustee, nor may his spouse. No successor trustee may be related by blood or marriage to the Donor or be in his employ or be a person or corporation subordinate to the Donor or a corporation in which the Donor is an executive or in which the Donor has significant stockholdings. Any successor trustee thus appointed, or, if the Trustee shall merge with or be consolidated with another corporate fiduciary, then such corporate fiduciary shall succeed to all the duties and to all the powers, including discretionary powers, herein granted to the Trustee.

IN WITNESS WHEREOF, the Donor has hereunto signed his name and affixed his seal, and the Trustee has caused its name to be hereunto signed by its proper officers, and its Corporate Seal to be hereunto affixed, all on the day and year first above mentioned.

.....

JAMES RICHARD HOLLINGWAY

.....

FIRST NATIONAL BANK OF JEFFERSON, MISSISSIPPI

(SEAL) By .....

Trust Officer

ATTEST:

.....

Secretary

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